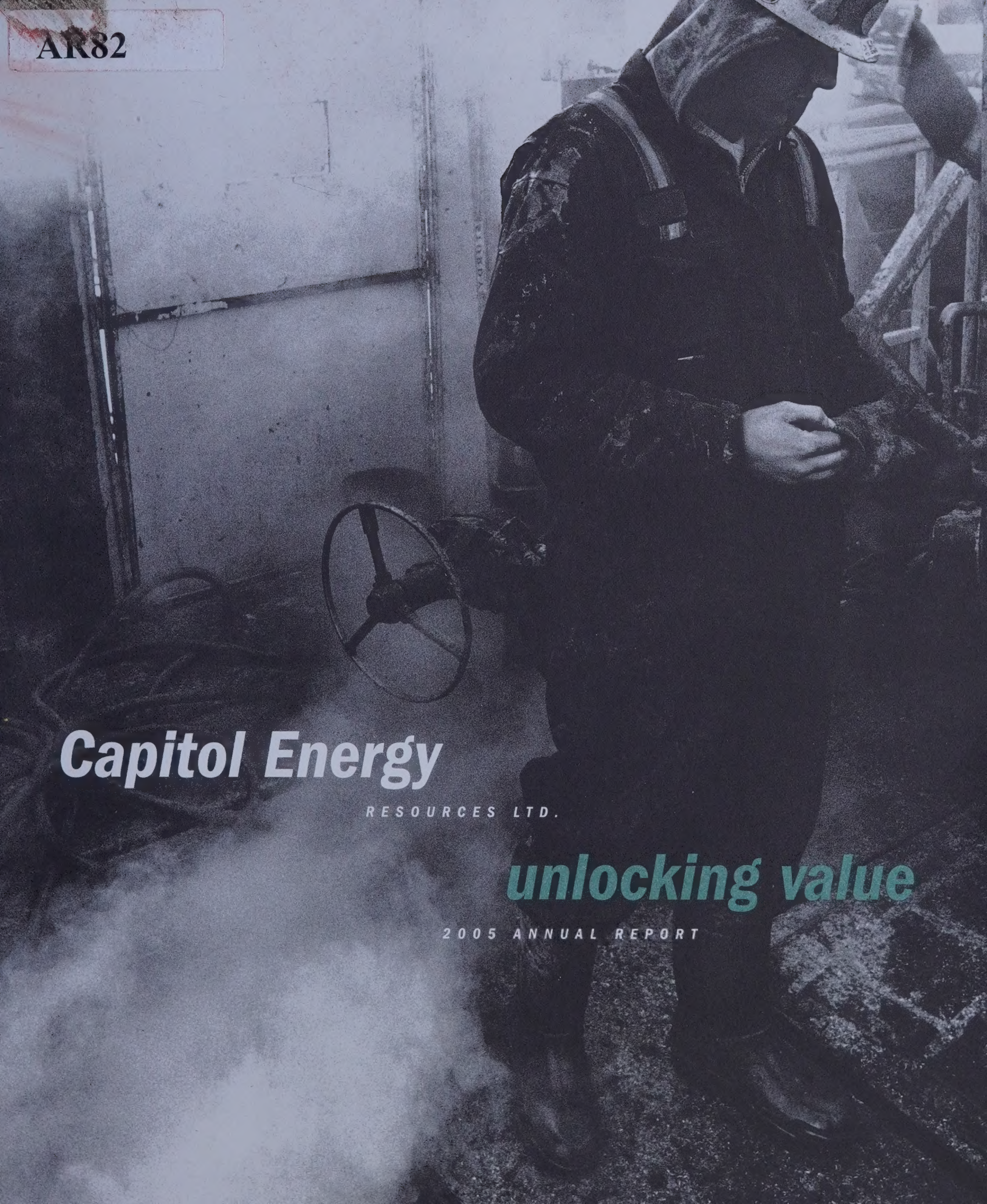

Capitol Energy

RESOURCES LTD.

unlocking value

2005 ANNUAL REPORT

ADVISORY: *Certain information about the Company presented in this annual report may constitute forward-looking statements under applicable securities laws, and may include references to non-GAAP measures. Please refer to pages 29 and 44 for special notes regarding non-GAAP measures and forward-looking statements.*

CPX

CAPITOL ENERGY IS AN INDEPENDENT JUNIOR EXPLORATION AND DEVELOPMENT COMPANY IN THE OIL AND GAS INDUSTRY. OUR BUSINESS STRATEGY INCLUDES BUILDING CORE AREAS THROUGH PRODUCTION ACQUISITIONS, DEVELOPMENT DRILLING AND HIGH-QUALITY EXPLORATION PROSPECTS THEREBY PROVIDING ABOVE AVERAGE RETURNS TO OUR SHAREHOLDERS. CAPITOL'S FOCUS IS THE DEVELOPMENT PROGRAM AT DIXONVILLE AND COMPLEMENTARY NATURAL GAS OPPORTUNITIES.

I am pleased to report 2005 was an outstanding year for Capitol. By adhering to our business plan and by being proactive accessing services, we have met all of our milestones and achieved positive growth in every area of our operation. The acquisition of Tiger Energy Limited followed by solid drilling results led to significant production and reserve growth at Dixonville and several new potential core areas from the exploration program.

We significantly increased our cash flow and reported positive earnings this past year. An ongoing focus on our cost structure resulted in reduced operating costs and significantly lower G&A costs, contributing to a strong financial performance.

UNLOCKING VALUE

Truly successful companies are those that effectively realize the value of all their assets, not merely their monetary or material assets. At Capitol, we unlock value by leveraging our core competitive advantages: the strength of Dixonville, our primary asset, the potential of our disciplined

exploration program, the depth of our staff, our management team and Board of Directors, our sound, responsible growth strategy and our strong balance sheet.

While we have benefited from strong commodity prices over the past year, our success is also attributable to the quality of our people at all levels in the Company. Being part of a highly competitive industry makes attracting and retaining key talent that much more of a challenge, one in which Capitol has been very successful. We were able to strengthen our team in 2005 through the addition of key staff in all disciplines and the addition of a new Director with strong technical and business skills. Our management team has more than 120 years of collective industry experience, a strength that allows us to execute our business plan with considerable effectiveness.

RESULTS OF OPERATIONS

Corporately, we exited 2005 with production at 2,500 boe/d, up significantly from last year's 342 boe/d. During the year, we acquired an additional 600 boe/d through the purchase of Tiger Energy Limited which included a 60% working interest in the Dixonville Montney "C" Pool, raising our position to essentially 100% working interest in this pool. This acquisition and our 29 well drilling program increased our net production from 342 boe/d to 2,300 boe/d and 160 mmbbls to 205 mmbbls original oil in place.

The construction of a new oil battery further expanded our oil processing capability to 4,000 bbls/d and 3.7 mmcf/d of gas processing capability at Dixonville. We also purchased a 20.6% working interest in the 10.9 mmcf/d Bilawchuk Gas Plant to process gas from an exploration discovery at Mulligan.

Our exploration results also speak to a very active year. We drilled 11 exploration and associated development wells resulting in seven gas wells and four D&A wells. We also tied in two wells at Helen, both of which were on-stream prior to the year end.

At the close of 2005, Capitol had 38,521 net undeveloped acres of land, up 343% from 8,693 net acres in 2004.

60%

ACQUIRED THE REMAINING 60% OF THE DIXONVILLE MONTNEY "C" OIL POOL

93%

DRILLED 32.8 SUCCESSFUL WELLS OUT OF 35.1 TOTAL NET WELLS FOR A 93% SUCCESS RATIO

500%

INCREASED OUR PROVED RESERVES TO 8.7 MMBOE AT YEAR END 2005, AN INCREASE OF OVER 500% FROM ONE YEAR EARLIER, BASED ON PRIMARY RECOVERY ONLY

1,004

AVERAGE ANNUAL PRODUCTION INCREASED FROM 144 BOE/D TO 1,004 BOE/D IN 2005

31.5

REPLACED 2005 PRODUCTION BY 31.5 TIMES ON A PROVED PLUS PROBABLE RESERVE BASIS

147

$147 MILLION IN AVAILABLE TAX DEDUCTIONS

85

THROUGH TWO SUCCESSFUL PRIVATE PLACEMENTS, WE RAISED $85 MILLION IN 2005. WE EMPLOYED THESE FUNDS TO FUND THE CAPITAL PROGRAM IN CONJUNCTION WITH CASH FLOW AND DEBT

38,521

38,521 NET UNDEVELOPED ACRES OF LAND, UP 343% FROM 8,693 NET ACRES IN 2004

16%

REDUCED PRODUCTION AND TRANSPORTATION EXPENSES BY 16% ON A PER BOE BASIS

FINANCIAL RESULTS

Our successes in 2005 are also reflected in our enhanced financial picture. Our revenue was $19.8 million in 2005, up substantially from $1.2 million in the previous year. Cash flow also increased significantly to $8.3 million and we reported positive earnings for the year.

Production and transportation expenses were $3.0 million in 2005 and our G&A costs were $3.2 million. Our production and transportation costs per unit of production decreased by more than 16% from $9.76/boe in 2004 to $8.17/boe in 2005. Our G&A costs for 2005 were $8.85/boe as compared to $36.33/boe in 2004. We completed two private placements during the year, raising $50 million in February and $35 million in September and we exited 2005 with $30.5 million in credit facilities consisting of a $23.5 million revolving credit facility and $7.0 million development facility.

UNLOCKING VALUE IN THE FUTURE

Continuing our approach from 2005, Capitol has secured drilling rigs for the balance of the 2006 drilling program. Aggressive development plans for 2006 include unlocking the inherent value of the Dixonville Montney "C" Pool by drilling 30 to 35 development wells which will lead to corporate exit production of 3,950 to 4,350 boe/d. In conjunction with increased production, the Dixonville oil battery and gas processing facility will be expanded as required. A pilot waterflood project is planned for 2006 with the ultimate goal of increasing recoverable oil to two to three times the recoverable reserves currently recognized by the independent qualified reserves evaluator.

We will continue to add strategic opportunities to our exploration inventory through land acquisitions and farm-ins. We also plan to drill 5 to 10 wells on existing lands during 2006 and expect to conduct 2D and 3D seismic programs to generate additional exploration and development locations.

OUR THANKS

Getting to this point has been done through the efforts and support of a number of people. Our staff has worked tirelessly to realize the full value of our assets while our management team has provided opportunities, ideas and strong leadership. Capitol's Board of Directors has consistently represented shareholders' interests by providing strong oversight and guidance.

And to our shareholders, we appreciate the support you have demonstrated as we executed our successful business plan. We further delineated the Dixonville Montney "C" Pool and it is now the largest oil pool discovered in Alberta in the last 25 years on an original oil in place basis. We are now poised to convert our substantial reserve base to production and cash flow, thereby rewarding you our shareholders by unlocking the value of the Company.

R.L. (Monty) Bowers, President and CEO, March 23, 2006

OPERATION HIGHLIGHTS	*year ended* *Dec 31* 2005	*six months ended* *Dec 31* 2004	*year ended* *June 30* 2004
Average daily sales			
Natural gas *(mcf/d)*	1,015	60	–
Oil *(bbls/d)*	835	134	3
Total *(boe/d)*	1,004	144	3
Netback *($/boe)*			
Average selling price	54.02	43.39	39.64
Royalties	13.61	10.88	11.10
Production and transportation expense	8.17	9.76	9.70
Realized netback	32.24	22.75	18.84
Drilling (net wells)			
Natural gas wells	5.0	–	–
Oil	27.8	2.4	–
Dry	2.3	–	–
Total	35.1	2.4	–

FINANCIAL HIGHLIGHTS *($ thousands except for per share amounts)*	*year ended* *Dec 31* 2005	*six months ended* *Dec 31* 2004	*year ended* *June 30* 2004
Petroleum and natural gas sales	19,803	1,151	44
Cash flow from (used in) operations	8,283	(246)	(1,649)
per share basic	0.21	(0.01)	(0.13)
Net income (loss)	9,000	(1,244)	(2,340)
per share basic	0.23	(0.06)	(0.19)
Capital expenditures	60,829	8,932	983
Corporate and asset acquisitions	49,514	–	5,174
Net working capital	(10,403)	8,367	12,652
Total assets	136,524	29,665	20,045
Shareholders' equity	114,702	23,012	18,809
Number of shares outstanding			
Common shares outstanding	47,988	22,356	21,291
Weighted average, diluted	39,835	21,401	12,559

↑

In 2005, we drilled 40 gross wells (35.1 net wells) including 29 horizontal wells at Dixonville for a 93% net success rate overall. Dixonville pool extensions increased original oil in place by 25% to 205,000 mbbls by the end of 2005, making it the largest conventional oil in place accumulation discovered in the last 25 years in Alberta.

OUR PRIMARY ASSET

The majority of Capitol's current production comes from its Dixonville property (Montney "C" oil pool) which is located approximately 65 kilometres northwest of Peace River, Alberta. Production is light oil (28-30 API) with some natural gas.

- *During 2005, the Dixonville Montney "C" oil pool was delineated by 3D seismic and confirmed by a multi-well drilling program. Favorable drilling resulted in pool extensions increasing original oil in place by 25% to 205 mmbbls. Based on EUB public data, the Dixonville Montney "C" oil pool is now the largest conventional oil in place accumulation discovered in the last 25 years in Alberta.*
- *Drilled 29 horizontal wells (27.8 net) for a 100% success rate during 2005.*
- *Proved reserves increased to 8.2 mmboe at year end 2005, an increase of 472% from December 31, 2004, based on primary recovery only.*
- *Proved plus probable reserves increased to 14.4 mmboe (including only 200 mboe for the waterflood pilot area) at year end 2005, an increase of 287% from December 31, 2004. Capitol's independent qualified reserves evaluator has assigned a primary recovery rate of 7.8%. Analog oil pools in Alberta have demonstrated a primary recovery rate in excess of 10%.*
- *Capitol intends to drill an additional 30 to 35 horizontal development wells to increase production and move reserves to the proved producing category.*

Capitol land base
seismic 3D area
pool area
potential pool extension
Nova gas line
gas cap
battery
well
water disposal well

2005

60

activity
- ACQUISITION OF OUTSTANDING 60% OF DIXONVILLE PROPERTY

value unlocked
- PROVIDED FULL CONTROL OF DEVELOPMENT OF PROPERTY
- ENHANCED PROJECT ECONOMICS

3D

activity
- 19 SQUARE MILE 3D SEISMIC SURVEY SHOT

value unlocked
- ASSISTED IN SELECTING OPTIMAL WELL LOCATIONS
- LOWERED DEVELOPMENT DRILLING RISK

29

activity
- DRILLED 29 HORIZONTAL WELLS AT DIXONVILLE WITH A 100% SUCCESS RATE

value unlocked
- ADDED PRODUCTION
- ADDED RESERVES
- INCREASED UNDERSTANDING OF POOL
- INCREASED REVENUE AND CASH FLOW

1

activity
- CONSTRUCTION OF NEW BATTERY

value unlocked
- 4,000 BBLS/D OIL CAPACITY
- 3,700 MCF/D GAS CAPACITY
- REDUCED SEASONAL TRANSPORTATION COSTS

↑
Our ongoing focus on reducing costs helped contain production and transportation expenses last year. On a per unit basis, production and transportation expenses averaged $8.17 per boe for 2005 versus $9.76 per boe for the six month period ended December 31, 2004. We also commissioned a new oil battery in the fourth quarter of 2005 and improved lease roads to help reduce variable trucking costs.

2006 >100 2-3x

activity
- CONFIRMED MORE THAN 100 FUTURE DEVELOPMENT LOCATIONS
- CAPITOL INTENDS TO DRILL 30 TO 35 HORIZONTAL DEVELOPMENT WELLS IN 2006

potential value
- INCREASE PRODUCTION
- MOVE RESERVES TO THE PROVED PRODUCING CATEGORY

activity
- PILOT WATERFLOOD IN 2006

potential value
- CONFIRM THE POTENTIAL TO INCREASE ULTIMATE RECOVERY TO 2 TO 3 TIMES PRIMARY RECOVERY CURRENTLY RECOGNIZED AT 7.8%

OUR DISCIPLINED EXPLORATION

Capitol Energy began exploratory efforts in May 2004 after the completion of the first phase of the Dixonville Montney "C" pool farm-in.

Our Goal

Build a series of complementary core gas dominated assets and maintain a low to medium risk drilling inventory.

Our Strategy

Adhere to two fundamental premises:

- *apply technical expertise in geology and geophysics in areas of historical success*
- *manage risk through diversifying play types and size of opportunity.*

Our Results

In 2005, Capitol made exploratory natural gas discoveries in four areas in West Central Alberta: Helen, Mulligan Creek, Dixonville South and Columbia. Capitol also continues to search for additional core areas in NE British Columbia.

exploration area

deformation front

provincial boundary

2005

HELEN

activities

- ASSEMBLED SIGNIFICANT LAND BASE THROUGH CROWN LAND SALES AND FARM-INS
- CONDUCTED MULTIPLE 2D SEISMIC SURVEY PROGRAMS
- DRILLED THREE NATURAL GAS WELLS
- CONSTRUCTED A NATURAL GAS GATHERING LINE TO BRING GAS TO MARKET

value unlocked

- SIX NEW POOL NATURAL GAS DISCOVERIES
- NINE DEVELOPMENT AND EXPLOITATION WELL LOCATIONS IN INVENTORY
- FIRST CORPORATE NATURAL GAS PRODUCTION OUTSIDE OF DIXONVILLE

DIXONVILLE SOUTH

activities

- ASSEMBLED SIGNIFICANT LAND BASE THROUGH CROWN LAND SALES AND FARM-INS
- CONDUCTED MULTIPLE 2D SEISMIC SURVEY PROGRAMS

value unlocked

- DRILLED A NATURAL GAS WELL
- TWO NEW POOL GAS DISCOVERIES
- TWELVE EXPLOITATION AND EXPLORATION WELL LOCATIONS IN INVENTORY

MULLIGAN CREEK

activities

- INCREASED LAND POSITION THROUGH FARM-IN DRILLING AND CROWN LAND SALES
- DRILLED TWO NATURAL GAS WELLS
- PURCHASED A WORKING INTEREST IN A NATURAL GAS PIPELINE AND THE BILAWCHUK 9-7-81-7W6 GAS PLANT

value unlocked

- ONE NEW POOL LIQUIDS RICH GAS DISCOVERY
- NINE EXPLOITATION AND EXPLORATION WELL LOCATIONS IDENTIFIED USING 3D SEISMIC SHOT IN 2004
- GAS PRODUCTION THROUGH WORKING INTEREST GAS INFRASTRUCTURE

↑

Capitol's exploration and development program outside of Dixonville was focused on gas opportunities and included wells at Helen, Mulligan, Columbia and Dixonville South. We drilled 11 exploration and associated development wells resulting in seven gas wells and four D&A wells. We also tied in two wells at Helen, both of which were on-stream prior to the year end.

2006

COLUMBIA

activities

- EARNED LAND POSITION THROUGH FARM-IN DRILLING
- DRILLED ONE GAS WELL
- CONSTRUCTED NATURAL GAS PIPELINE WITH PARTNER

value unlocked

- ONE NEW POOL LIQUIDS RICH NATURAL GAS DISCOVERY
- GAS TO BE TIED IN Q1 2006

activities

- PROJECTS: CONTINUE TO EXPLORE FOR COMPLEMENTARY GAS ASSETS
- SEISMIC: SHOOT 2D AND 3D DATA WITHIN ACTIVE EXPLORATORY AREAS
- DRILLING: 5 TO 10 EXPLORATION WELLS IN 2006
- LAND: CONTINUE TO IDENTIFY PROSPECTIVE FARM-INS OR POST CROWN LAND

potential value

- ADD PRODUCTION OF APPROXIMATELY 700 BOE/D
- ADD NATURAL GAS RESERVES TO COMPLIMENT CURRENT OIL DOMINATED PORTFOLIO
- TEST EXPLORATION CONCEPTS IN NEW AREAS INCLUDING GAGE, BOUNDARY LAKE, DIXONVILLE AREA EXTENSION, WEST STODDART (NEBC)

OUR EXPERIENCED PEOPLE

We have the production, we have the exploration, we have the strategy and we have financial strength. To successfully unlock the value within our Company, it is the people that ultimately deliver.

Strong individuals make for a strong team. The execution of our development is being carried out by a strong team supported by management with more than 120 years of collective experience and under the leadership of a Board of Directors who are a networked group of experienced business people able to address the challenges that lie ahead.

With the knowledge to question management and experience to guide our organization, our Board monitors corporate performance against agreed benchmarks and they use their experience and acquired wisdom to contribute to the Company's strategic direction. We added new strength to the Board this year with the election of Murray Nunns, who took over the Chairmanship of the Reserve Committee.

Effective management of growing companies is a fundamental building block for further growth. Our results in 2005 speak to the effectiveness of our management team and professional staff and provide the promise for 2006 and beyond.

management

finance

exploration, production & land

Dixonville

FULL TIME STAFF

20

Capitol's dynamic staff has grown to 20 over the past year.

1 *R.L. (Monty) Bowers, President & CEO*

2 *D.C. (Don) Stachiw, Vice President, Exploration & COO*

3 *Doug Dearing, Vice President, Finance & CFO*

4 *Cathy Elliott, Manager, Operations Accounting*

5 *Scott Greenshields, Controller*

6 *Aaron Johnson, Financial Analyst*

7 *Cindy Verhees, Accounting Clerk*

8 *John Lamacchia, Vice President, Engineering & Operations*

9 *John Nesbitt, Vice President, Land*

10 *Bari McDowell, Exploration Technologist*

11 *Patrick Rogers, Chief Geophysicist*

12 *Patrick Elliott, Staff Geologist*

13 *Tyson Huska, Exploitation Engineer*

14 *Kevin Evers, Geologist*

15 *Debbie Kniss, Engineering Technical Assistant*

16 *Ken Pitts, Senior Engineer*

17 *Harvey Jacobsen, Field Superintendent*

18 *Jerry McGregor, Senior Operator*

19 *Chris Bartole, Senior Landman*

20 *Jade Cooper, Executive Assistant*

Our strong and experienced team hold the keys to unlocking the value at Capitol. With more than 120 years of collective industry experience, a management team with hands-on experience gained through working at more than 19 peer-group companies, and a strong, independent Board of Directors, Capitol is well placed to continue unlocking shareholder value in the future.

25

R.L. (Monty) Bowers
President & Chief Executive Officer
25 years of industry experience
- Petromet
- Remington
- Amerada
- Shell Canada

25

Doug Dearing
Vice President, Finance & Chief Financial Officer
25 years of industry experience
- Financial Consultant E&P
- AEC
- Hardy
- Bralorne Resources
- Price Waterhouse

21

Don Stachiw
Vice President, Exploration & Chief Operating Officer
21 years of industry experience
- EnCana
- Defiant
- Barrington
- Summit
- Amerada
- Chevron

25

John Lamacchia
Vice President, Engineering & Operations
25 years of industry experience
- Nycan
- Founders
- Richland
- TCPL Resources
- Shell Canada

25

John Nesbitt
Vice President, Land
25 years of industry experience
- Talisman
- Home
- Consultant

OUR FINANCIAL PLATFORM

Maintaining financial strength while achieving cost effective reserve and production growth per share is a challenge in a high cost environment. Capitol has the financial flexibility and strong balance sheet required to fund a disciplined exploration and production program. We have sufficient cash flow and credit available to take advantage of a portfolio of additional strategic exploration opportunities in the next twelve months.

Capitol's flexibility comes from $85 million of new equity raised through two private placements during 2005 and credit facilities which were increased to $50 million in March 2006. Capitol is also entitled to issue equity on a short form prospectus basis in addition to the traditional private placement form of issuing new equity.

Capitol's high standards of disclosure and transparency in internal and external financial reporting provide useful and meaningful information to manage the operations, measure performance and establish a strong financial platform to pursue growth.

2005

85

– TWO PRIVATE PLACEMENTS RAISED $85 MILLION IN GROSS PROCEEDS FOR CAPITOL

30.5

– CAPITOL ESTABLISHED A CREDIT FACILITY OF $30.5 MILLION

An ongoing oil and gas exploration program requires a strong financial platform to support it. Our solid financial position allows us to continue our disciplined development – in 2005, we generated close to $20 million in sales, raised $85 million through two private placements and established credit facilities of over $30 million.

1:5

– CAPITOL SHAREHOLDERS APPROVED A SHARE CONSOLIDATION AT THE ANNUAL MEETING IN MAY, WITH ONE NEW SHARE ISSUED FOR EVERY FIVE OUTSTANDING

8.17

– PRODUCTION AND TRANSPORTATION COSTS PER BOE WERE REDUCED MORE THAN 16% TO $8.17 FROM $9.76 IN 2004

19.8

– PETROLEUM AND NATURAL GAS SALES OF $19.8 MILLION WERE UP FROM $1.2 MILLION IN SALES FOR THE SIX MONTHS ENDED DECEMBER 31, 2004

8.3

– CASH FLOW FROM OUR 2005 OPERATIONS WAS $8.3 MILLION

OUR GROWTH STRATEGY

Our Goal

Generate maximum share value through a disciplined deployment of capital on development, exploration and complementary acquisition opportunities in our core focus area.

Our Strategy

Maximize the economic value of the Dixonville Montney "C" Pool by:

- *Drilling development wells to the optimal inter-well spacing through 2006 and 2007 and expanding production facilities in parallel with rising production.*
- *Implementing a pilot waterflood project in 2006 to confirm the reservoir simulation results and increase ultimate oil recovery, followed by full field waterflood beginning in 2007.*

Maximize the impact of our exploration program by:

- *Building on success at Helen and Dixonville South with multi-well exploration and drilling programs and expanding gathering and processing facilities.*
- *Applying rigorous selection criteria to our exploration opportunity portfolio to maintain an inventory of exploration projects.*
- *Focusing on internally generated exploration opportunities.*

Evaluate and pursue strategic acquisitions that support our activities in core areas.

RESERVE HIGHLIGHTS (based on forecast pricing)

Reserve Volumes

Working interest reserve volumes before royalties (mboe)	*Dec 31 2005*	*Dec 31 2004*	*June 30 2004*
Proved	8,711	1,438	523
Probable	6,554	2,286	652
Total proved plus probable	15,265	3,724	1,175
Possible *	9,388	2,811	1,403
Total proved plus probable plus possible *	24,653	6,535	2,578

Pre-Tax Net Present Values ($ thousands)	*Dec 31 2005*	*Dec 31 2004*	*June 30 2004*
Undiscounted			
Proved	208,208	21,359	5,903
Probable	176,476	38,222	7,023
Proved plus probable	384,684	59,581	12,926
Discounted at 10%			
Proved	139,821	13,955	4,048
Probable	90,672	18,765	3,484
Proved plus probable	230,493	32,720	7,532

* *Non compliant reserve measure under NI 51-101, data provided for information purposes only*

G R O W T H

MAXIMIZE THE ECONOMIC VALUE OF THE DIXONVILLE MONTNEY "C" POOL

2005 **500%**

- **INCREASED PROVED RESERVES BY 500%**
- **INCREASED PROVED PLUS PROBABLE RESERVES BY 300%**

MAXIMIZE THE IMPACT OF OUR EXPLORATION PROGRAM

S T R A T E G Y

We had an extremely successful 2005 and have put in place the disciplined strategy to repeat that success in 2006 and beyond. Last year, we replaced production by 31.5 times on a proved plus probable basis. We expect to spend at least $55 million on exploration and development activities and see an average production of 3,000 to 3,400 boe per day in 2006.

EVALUATE AND PURSUE STRATEGIC ACQUISITIONS THAT SUPPORT OUR ACTIVITIES IN CORE AREAS

93%
– DRILLED 40 GROSS WELLS (35. 1 NET WELLS) AT A 93% SUCCESS RATE

125
– INCREASED DRILLING INVENTORY TO 125 WELLS FROM 85 WELLS AT YEAR END 2004

31.5
– REPLACED PRODUCTION BY 31.5X ON A PROVED PLUS PROBABLE BASIS

76%
– REDUCED G&A COSTS/BOE BY 76%

2500
– INCREASED PRODUCTION TO 2500 BOE/D (DIXONVILLE 2300 BOE/D) FROM 342 BOE/D

Management's discussion and analysis ("MD&A") of Capitol Energy Resources Ltd. ("Capitol" or "the Company") financial results should be read in conjunction with the audited financial statements for the year ended December 31, 2005, the six month period ended December 31, 2004 and the year ended June 30, 2004. The MD&A offers management's opinion of Capitol's historical financial and operating results and is dated and based on information available at March 22, 2006. Any prospective estimates are based on assumptions of future events and may be subject to change.

Capitol may use the terms "cash flow from operations", "cash flow", "cash flow per share", "net operating income", and "netbacks" which are not recognized measures under Canadian generally accepted accounting principles ("GAAP"). Management believes that in addition to net earnings, cash flow is a useful supplemental measure as it provides an indication of the results generated by the Company's principal business activities before the consideration of how those activities are financed or how the results are taxed. Investors are cautioned, however, that this measure should not be construed as an alternative to net earnings determined in accordance with GAAP. Capitol's method of calculating cash flow may differ, and may not be comparable to measures calculated by other companies. Capitol calculates cash flow from operations before the change in non-cash working capital related to operating activities.

Natural gas volumes have been converted to barrels of oil equivalent ("boe") at a ratio of six thousand cubic feet ("mcf") of natural gas to one barrel of oil equivalent. This conversion ratio is based upon an energy equivalent conversion method primarily applicable at the burner tip and does not represent value equivalence at the wellhead. Boe figures may be misleading, particularly if used in isolation.

All references to dollar values refer to Canadian dollars. All amounts in the narrative and tabular form are in thousands of dollars except $ per boe, $ per share amounts, shares, and land holdings.

All common share and per share amounts have been restated to retroactively reflect the consolidation of the Company's shares in May 2005.

Additional information relating to Capitol, including Capitol's Annual Information Form and annual audited financial statements is available at www.sedar.com or on the Company's website at www.capitolenergy.ca.

BACKGROUND

Prior to December 3, 2003, the Company was called Cell-Loc Inc. ("Cell-Loc") and was in the technology business of research, development and licensing wireless location products, which integrated global positioning, wireless communications and geographical information systems with proprietary hardware and software. On December 1, 2003, the shareholders of Cell-Loc voted to approve a Plan of Arrangement (the "Plan"), pursuant to which Cell-Loc had agreed with a private investment partnership to complete concurrent equity financing, asset sale and technology asset distribution transactions. On December 2, 2003, the Court of Queen's Bench of Alberta approved the Plan. Upon the closing of the Plan on December 2, 2003, Cell-Loc was renamed Capitol Energy Resources Ltd. At that time, the Company's shares were delisted from the Toronto Stock Exchange and re-listed for trading on the TSX Venture Exchange.

All operations from July 1, 2003 to December 2, 2003 have been reported as discontinued operations. All operations from December 3, 2003 have been reported as continuing operations during which the Company investigated oil and gas acquisition opportunities.

On May 4, 2004, the Company completed an asset acquisition at Dixonville in west central Alberta that commenced production on June 26, 2004 at 125 boe per day. The June 30, 2004 financial statements included general and administrative costs and 5 days of oil and gas production operations.

COMPARABLE PERIODS

During 2004, Capitol changed its reporting year end from June 30 to December 31 to be consistent with its peer group of oil and gas companies that report on a calendar year basis. The transition year resulted in six months of operations that ended December 31, 2004. With a transition period of less than nine months, in accordance with National Instrument 51-102, Capitol has added the previous fiscal year, July 1, 2003 to June 30, 2004 to this MD&A and financial statements for comparative purposes.

The financial statements referenced in this MD&A are for the year ended December 31, 2005, the six month period ended December 31, 2004 and the year ended June 30, 2004. All references in this MD&A to December 2004 are for the six month period ended December 31, 2004 unless otherwise specified. All references in this MD&A to June 30, 2004 are for the twelve month period ended June 30, 2004 unless otherwise specified.

Comparative information has been provided in the tables to the MD&A with respect to the oil and gas operations for the year ended June 30, 2004. Due to the insignificance of the oil and gas operations for that period the discussion and analysis of oil and gas operations in this MD&A is focused on the year ended December 31, 2005 and the six month period year ended December 31, 2004.

2005 HIGHLIGHTS

Activities

- Acquisition of Tiger Energy Limited, for $49,514, that provided Capitol the remaining 60% ownership and development control of the Dixonville property.
- Oil and gas capital expenditures were $60,668 including $41,026 on further development at Dixonville.
- During 2005, the Dixonville Montney "C" oil pool was delineated by 3D seismic and confirmed by a multi-well drilling program.

  Drilled 40 gross wells (35.1 net wells) including 29 horizontal wells at Dixonville for a 93% net success rate overall (100% success rate at Dixonville) during 2005.
- Increased undeveloped land portfolio by approximately 28,000 net acres in west central Alberta.

Source of funds

- Operations were funded with two private placements raising gross proceeds of $85 million, cash flow, and working capital.
- Capitol established a $23,500 revolving credit facility and a $7,000 development facility to fund further development at Dixonville.

Results

- Favourable drilling at Dixonville resulted in pool extensions increasing original oil in place by 25% to 205,000 mbbls.
- Proved reserves increased to 8,711 mboe at year end 2005, an increase of over 500% from December 31, 2004 based on primary recovery only.
- Proved plus probable reserves increased to 15,264 mboe (including only 200 mboe for the water-flood pilot area) at year end 2005, an increase of over 300% from December 31, 2004. Capitol's independent qualified reserves evaluator has assigned a primary recovery rate of 7.8%.
- Capitol's proved, probable plus possible reserve base is 24,653 mboe.
- Capitol's proved plus probable RLI was 16.7 years at year end 2005 while the proved RLI was 9.5 years based on year end production rates of 2,500 boe per day.
- Proved plus probable reserves per common share outstanding increased by 91% to 318 boe/thousand shares.
- Net Present Value, at forecast prices and costs, of total proved plus probable reserves discounted at 5% before tax increased by 575% to $291,780 ($230,493 NPV discounted at 10%).
- Finding, development and acquisition ("FD&A") costs were $20.94 per proved boe and $16.39 per proved plus probable boe calculated pursuant to National Instrument 51-101.
- FD&A costs since inception are $14.38 per proved plus probable boe on the same basis. Excluding future development capital, the Company's FD&A costs since inception are $7.83 per proved plus probable boe.
- 2005 production exit rate of 2,500 boe per day.
- 2005 average production rate of 1,004 boe per day, with a fourth quarter average of 1,557 boe per day.

SELECTED ANNUAL INFORMATION

($ thousands except share and per share data)	*Dec 31* 2005	*Dec 31* 2004	*June 30* 2004
Production revenue net of royalties and ARTC	14,815	862	32
Cash flow from (used in) operations*	8,283	(246)	(1,649)
Per share, basic	0.21	(0.01)	(0.13)
Net income (loss) from continuing operations	9,000	(1,244)	(1,257)
Per share, basic and diluted	0.23	(0.06)	(0.10)
Net income (loss)	9,000	(1,244)	(2,340)
Per share, basic and diluted	0.23	(0.06)	(0.19)
Total assets	136,524	29,665	20,045

* *non-GAAP measure*

DISCUSSION OF COMPARABLE RESULTS

SALES VOLUMES

(at 6 mcf:1 boe)	*Dec 31* 2005	*Dec 31* 2004	*June 30* 2004
Natural gas *(mcf/d)*	1,015	60	–
Oil *(bbls/d)*	835	134	3
Total *(boe/d)*	1,004	144	3

Sales volumes for 2005 averaged 1,004 boe per day, an increase of approximately 600% over the period ended December 31, 2004. The increase in volumes for 2005 resulted from the acquisition of Tiger Energy Limited ("Tiger") on February 28, 2005 which was producing approximately 600 boe per day combined with additional production from 29 development wells drilled at Dixonville during the year.

Sales volumes in the fourth quarter of 2005 averaged 1,557 boe per day, an increase of approximately 850% over the fourth quarter of 2004 as a result of new production at Dixonville and Helen.

AVERAGE COMMODITY PRICES

	Dec 31 2005	Dec 31 2004	June 30 2004
Benchmarks			
West Texas Intermediate crude oil *($US/bbl)*	56.56	46.08	33.71
Edmonton par crude oil *($C/bbl)*	69.29	57.33	44.57
Natural gas (cash daily) at AECO *($C/GJ)*	8.77	6.39	6.26
Exchange rate *($C/$US)*	0.83	0.79	0.75
Realized Prices			
Natural gas *($/mcf)*	9.19	5.76	–
Oil *($/bbl)*	53.79	44.03	39.68

Oil and gas commodity prices increased over 2004 from ongoing demand for products and supply shortfalls as a result of hurricanes and hurricane damage in the gulf coast of the United States.

Capitol's realized crude oil priced at Dixonville averaged $53.79 per bbl for 2005 compared to $44.03 for the period ended December 31, 2004. Increasing supplies of heavier crude and limited refining capacity in Canada caused quality differentials for heavier crude compared to light sweet crude prices to widened throughout the year. As a result, Capitol's realized price was reduced by an average crude oil quality differential of $15.50 per barrel for the year ended December 31, 2005.

The crude oil quality differential expanded to $18.20 per barrel in the fourth quarter of 2005 with a high of $22.78 per barrel in December.

Capitol has not hedged any commodity prices or foreign exchange rates. Capitol sells all of its oil and natural gas on the spot market, therefore future prices will fluctuate with the prevailing market prices of crude oil and natural gas.

REVENUES

($ thousands)	Dec 31 2005	Dec 31 2004	June 30 2004
Natural gas	3,405	64	–
Oil	16,398	1,087	44
Production revenue	19,803	1,151	44
Interest	181	115	32
Total revenue	19,984	1,266	76

The increased production revenue in 2005 versus the six month period ended December 31, 2004 is due to the impact of full year results versus the transition period, the increase in 2005 daily average production rates and improved commodity pricing. Nominal amounts of production revenue for the year ended June 30, 2004 was the result of production commencing on June 26, 2004.

Interest income resulted from cash balances on hand during the reported periods invested at Bankers Acceptance rates.

ROYALTIES

($ thousands except per boe amounts)	Dec 31 2005	Dec 31 2004	June 30 2004
Crown	3,945	220	12
Overriding and freehold	1,672	117	–
Total royalties	5,617	337	12
Alberta royalty tax credit ("ARTC")	(629)	(48)	–
Net royalties	4,988	289	12
Per boe *($/boe)*	13.61	10.88	11.10
Percent of total production revenue	25.2%	25.1%	28.0%

Royalty rates before ARTC decreased compared to 2004, averaging 28% for 2005 versus 29% for the six months ended December 31, 2004. Capitol drilled several wells on lands that are not subject to gross overriding royalties resulting in a reduced average royalty rate per well.

Capitol is forecasting royalty rates before ARTC to average 25% to 28% for 2006.

Capitol's crown royalty expense is forecasted to exceed $2,000 for its taxation year ended June 30, 2006. Capitol expects that ARTC will become a smaller percentage of the total royalties, and as a result, royalties after ARTC as a percentage of revenue is expected to increase as Capitol grows its production.

PRODUCTION EXPENSES AND TRANSPORTATION COSTS

($ thousands except per boe amounts)	*Dec 31* 2005	*Dec 31* 2004	*June 30* 2004
Production	1,354	184	8
Transportation	1,640	75	3
Total	2,994	259	11
Per boe *($/boe)*	8.17	9.76	9.70
Percent of total production revenue	15.1%	22.5%	24.5%

Production and transportation expenses, totaled $2,994 in 2005 compared to $259 for the six months ended December 31, 2004. Higher daily average production volumes and 12 months of operations in 2005 resulted in higher production costs on a year over year basis. Production expenses for the year ended June 30, 2004 were insignificant as a result of initial production commencing on June 26, 2004.

On a per unit basis, production and transportation expenses averaged $8.17 per boe for 2005 versus $9.76 per boe for the six month period ended December 31, 2004. Increased production volumes to share the fixed costs at Dixonville resulted in decreased production expenses on a per unit basis in 2005 compared to 2004. In addition, Capitol commissioned a new oil battery in the fourth quarter of 2005 and improved lease roads to help reduce variable trucking costs.

The majority of transportation costs are for trucking crude oil from Dixonville to third party pipeline terminal access points. Trucking rates include a fixed rate per barrel plus a time component for waiting time at the terminal and variable travel times from seasonal road conditions.

We anticipate operating costs to improve slightly as the Company increases production volumes with existing oil battery capacity. Trucking costs may be volatile during the second quarter when weight restrictions from municipal road bans are traditionally in place. The Company is forecasting production and transportation costs to average $8.00 to $8.50 per boe for 2006.

GENERAL AND ADMINISTRATIVE EXPENSES ("G&A")

($ thousands except per boe amounts)	*Dec 31* 2005	*Dec 31* 2004	*June 30* 2004
People costs	2,845	549	355
Office costs	511	116	60
Corporate costs	611	301	250
Capitalized G&A and overhead recoveries	(721)	(2)	–
G&A expense	3,246	964	665
Per boe *($/boe)*	8.85	36.33	592.88

General and administrative expenses have increased in 2005 over the six month period ended December 31, 2004, due to a full year of expenses versus a six month reporting period and from increased staffing and office space required to develop and manage exploration activities and production growth.

During 2005, the Company capitalized $710 in general and administrative expenses as a result of the Company increasing its exploration and development activities in the third quarter of 2005. The Company did not capitalize general and administrative expenses during the previous comparable periods.

Capitol expects future general and administrative expenses to increase slightly in 2006 through staff additions planned to help manage production growth. Capitol anticipates general and administrative expenses per unit of production to trend downwards in 2006 as a result of increased production.

STOCK BASED COMPENSATION

Stock based compensation expense of $5,025 was recorded for 2005 versus $583 for the period ended December 31, 2004 and $616 for the twelve months ended June 30, 2004. The stock based compensation expense has increased in 2005 as a result of new stock options issued during 2005.

During 2005, the Company granted 2,241,000 stock options to employees at prices averaging $4.81 per share. Consistent with the vesting terms of the options, one third of the estimated value of the options is expensed on the grant date with the remaining option value amortized over remaining vesting periods on a straight line basis.

Capitol expects to expense $2,017 in 2006 and $383 in 2007 in respect of stock options issued and outstanding at December 31, 2005.

DEPLETION, DEPRECIATION AND ACCRETION ("DD&A")

DD&A expense for the year ended December 31, 2005 was $7,910 compared to $415 for the six month period ended December 31, 2004. The expense increased as a result of higher production volumes and higher DD&A rates per boe of production from the Tiger acquisition. A significant portion of the Tiger acquisition value was related to probable and possible reserves, while only proved reserve volumes are used to determine the DD&A rate.

All of Capitol's property and equipment was subject to depletion and depreciation at December 31, 2005, with the exception of unproved property costs of $4,740.

We anticipate the DD&A rate to decrease as Capitol increases its proven reserves from the proposed 2006 drilling program through the conversion of probable and possible reserves associated with Dixonville. Although Capitol has used current industry costs to determine its future development costs that are included in the DD&A rate, continued price increases from service providers may offset some of the anticipated decreases.

INTEREST EXPENSE

Interest expense of $385 for 2005 relates to $263 payable under Part XII.6 of the Income Tax Act and $122 in respect of amounts drawn during the year on the Company's banking facilities. There was no interest expense from continuing operations for the prior periods.

Part XII.6 tax, computed by reference to unspent flow through share commitments and prescribed rates was incurred by the Company for the first time in 2005. The tax was payable on flow through share amounts renounced effective December 2004 but not fully incurred by Capitol prior to March, 2005.

INCOME TAXES

The Company recorded a current tax expense of $88 in 2005 for large corporation's tax. The Company was not subject to large corporation's tax in the prior fiscal years. Capitol does not expect to pay any current tax other than large corporation's tax for 2006.

During 2005 Capitol recorded a recovery of future income taxes of $13,652. In prior years, the Company did not recognize its future income tax assets and recorded a valuation allowance limiting their recognition to amounts which were "more likely than not" to be utilized.

During the first quarter of 2005, $3,816 of previously unrecognized tax assets were recorded in the income statement to offset future tax liabilities recorded on the renunciation of flow through share amounts net of share issue costs. In the fourth quarter of 2005, $9,836 of previously unrecognized tax assets were recorded in the income statement as a result of Capitol determining it would be able to utilize its tax assets on a more likely than not basis.

In conjunction with the business combination with Tiger, the Company recognized a future income tax benefit of approximately $11,089 to eliminate future tax on the excess of allocated values over Tiger tax deductions.

In 2005, the Company raised $5,517 from flow through share offerings to be spent on qualifying Canadian exploration expenditures by December 31, 2006. At December 31, 2005, the Company had incurred approximately $1,250 in respect of the flow through shares issued in 2005. We anticipate that the remaining exploration expenditures of $4,267 will be incurred during the first quarter of 2006.

ESTIMATE OF AVAILABLE TAX DEDUCTIONS *($ thousands)*	*Dec 31* 2005
Canadian oil and gas property expenditures	7,200
Canadian development expenditures	36,400
Canadian exploration expenditures	8,400
Undepreciated capital costs	49,000
Share issue costs	5,400
Non-capital losses	36,600
Scientific research and development expenditures and other	4,000
Total	147,000
Qualifying expenditures incurred to December 31 be renounced to shareholders	(1,250)
Net	145,750

The estimate of available tax deductions does not reflect the commitment to incur future expenditures of approximately $4,267 on flow through shares issued during 2005.

DISCONTINUED OPERATIONS

The Company's activities for the period July 1, 2003, to December 2, 2003, were reported as discontinued operations as the Company wound down the technology business leading up to the Plan approved by shareholders on December 1, 2003. There were no discontinued operations for the year ended December 31, 2005 and the six month transition period ended December 31, 2004.

The Company reported a $1,083 loss from discontinued operations for the year ended June 30, 2004. The loss included $78 of licensing revenue offset by $107 of operating costs, $1,066 of general and administrative costs, a $400 gain on settlement of trade liabilities, and marketing foreign exchange, depreciation, and interest expenses of $388.

RECONCILIATION OF NON GAAP MEASURES *($ thousands)*	*Dec 31* 2005	*Dec 31* 2004	*June 30* 2004
Net income (loss) from continuing operations	9,000	(1,244)	(1,257)
Non-cash items			
Stock based compensation	5,025	583	616
Depletion, depreciation and accretion	7,910	415	29
Recovery of future income taxes	(13,652)	–	–
Cash flow from (used in) continuing operations	8,283	(246)	(612)
Funds used in discontinued operations		–	(1,955)
Changes in discontinued operations non-cash working capital	–	–	918
Cash flow from (used in) discontinued operations	–	–	(1,037)
Cash flow from (used in) operations	8,283	(246)	(1,649)
$ per share – basic	0.21	(0.01)	(0.13)

			Dec 31 2005	Dec 31 2004	June 30 2004
NETBACKS PER BOE	natural gas ($/mcf)	oil ($/bbl)	total ($/boe)	total ($/boe)	total ($/boe)
Production revenue	9.19	53.79	54.02	43.39	39.64
Royalties, net of ARTC	2.91	12.82	13.61	10.88	11.10
	6.28	40.97	40.41	32.51	28.54
Production and transportation	0.77	8.88	8.17	9.76	9.70
Operating netback	5.51	32.09	32.24	22.75	18.84
Interest income			0.49	4.33	28.37
General and administrative			(8.85)	(36.33)	(592.88)
Interest expense			(1.05)	–	–
Current income taxes			(0.24)	–	–
			22.59	(9.25)	(545.67)
Stock based compensation			(13.71)	(21.98)	(549.96)
DD&A			(21.58)	(15.66)	(25.58)
Recovery of future income taxes			37.24	–	–
Net income (loss) from continuing operations per boe			24.54	(46.89)	(1,121.21)

CAPITAL ADDITIONS ($ thousands)	Dec 31 2005	Dec 31 2004	June 30 2004
Property and equipment additions			
Land	2,583	876	40
Seismic	5,952	1,275	–
Drilling and completions	41,187	6,207	40
Equipping and facilities	10,236	475	871
Capitalized G&A	710	–	–
Oil and gas additions	60,668	8,833	951
Administrative assets	161	99	32
Capital expenditures before acquisitions	60,829	8,932	983
Asset acquisitions *	47,251	–	5,174
Asset retirement costs	1,076	108	145
Total capital additions	109,156	9,040	6,302

* On February 28, 2005, the Company closed the acquisition of all of the issued and outstanding shares of Tiger for $49,352 plus acquisition costs of $162 for a total cost of $49,514. On the acquisition, $47,251 was allocated to property and equipment.

In 2005, the Company drilled 29 horizontal wells at Dixonville, all of which were on production by year end. Capitol constructed a new oil battery, tied in all producing wells and improved lease roads to minimize oil handling and transportation costs. The 2005 capital program to develop the Dixonville Montney "C" oil pool was $41,026.

Capitol's exploration and development program outside of Dixonville was focused on gas opportunities and included wells at Helen, Mulligan, Columbia, and Dixonville South. Capital expenditures for these areas were $18,932. This program resulted in 4.0 gross wells (3.2 net) at Helen, 3.0 gross wells (1.35 net) at Mulligan, 2.0 gross wells (1.25 net) at Columbia, 1.0 gross well (1.0 net) at Dixonville South and 1.0 gross well (0.45 net) at Royce with a success rate of 64% gross (69% net).

DRILLING SUMMARY	Dec 31 2005 gross	Dec 31 2005 net	Dec 31 2004 gross	Dec 31 2004 net	June 30 2004 gross	June 30 2004 net
Natural gas	7.0	5.0	–	–	–	–
Oil	29.0	27.8	6.0	2.4	–	–
Dry	4.0	2.3	–	–	–	–
Total	40.0	35.1	6.0	2.4	–	–

LAND HOLDINGS *(in acres)*	gross developed	gross undeveloped	gross total	net developed	net undeveloped	net total
June 30, 2004	950	3,903	4,853	380	1,561	1,941
December 31, 2004	3,719	20,395	24,114	1,594	8,693	10,287
December 31, 2005	14,330	48,420	62,750	11,836	38,521	50,357

DRILLING SUMMARY *(see table above)*

In addition to the wells noted above, at December 31, 2005, the Company had 1.0 (0.5 net) well which was standing and awaiting completion.

LAND HOLDINGS *(see table above)*

Capitol grew its land position during 2005 through acquisitions at crown sales and farm-ins. In addition, Capitol has exposure at December 31, 2005 to approximately 35,200 gross acres of undeveloped land through farm-in option agreements.

RESERVES

Capitol's proved reserves at December 31, 2005 were 8,711 mboe an increase of over 500% over December 31, 2004 reserve volumes of 1,438 mboe. The increase in reserves at December 31, 2005 versus December 31, 2004 resulted from the Tiger acquisition and reserve additions from exploration and development activities conducted during the year.

Capitol has a Reserves Committee of independent board members that reviews the qualifications and appointment of an independent qualified reserves evaluator to evaluate the Company's reserves. The Reserves Committee also reviews the procedure for providing information to the evaluators. Readers are advised to review Capitol's full disclosure of reserves filed on SEDAR with the Company's 2005 financial results.

LIQUIDITY AND CAPITAL RESOURCES

The Company utilized cash flow, cash balances, and the proceeds from subscription receipts and share issuances to fund exploration and development activities for the year ended December 31, 2005.

At December 31, 2005, the Company had a working capital deficit of $10,403 and un-drawn credit facilities of $30,500 comprised of a $23,500 revolving credit facility and a $7,000 non-revolving development facility. On March 15, 2006, the Company's revolving credit facility was increased to $30,000 and its non-revolving development facility was increased to $20,000.

Capitol expects to fund its 2006 capital program with cash flow generated from production activities, use of bank credit facilities or alternate financing arrangements.

Capitol monitors its production, expected cash flows, credit facilities and the equity markets to allow for flexibility with its capital expenditure program. Capitol has not hedged any production volumes. Capitol has a large inventory of development locations at Dixonville and a portfolio of exploration opportunities that is continually balanced and prioritized to match cash flows and financing capabilities.

CONTRACTUAL OBLIGATIONS *($ thousands)*	2006	2007 *to* 2008	2009 *to* 2010	*after* 2010	*total*
Asset retirement obligations	–	–	–	4,346	4,346
Purchase of goods and services	750	–	–	–	750
Office lease	252	529	246	–	1,027
Total contractual obligations	**1,002**	**529**	**246**	**4,346**	**6,123**

CONTRACTUAL OBLIGATIONS

Additional information relating to the Company's contractual obligations is disclosed in note 13 to the financial statements.

OFF BALANCE SHEET ARRANGEMENTS

The Company does not have any off-balance sheet arrangements that will have an effect on its results of operations or financial condition.

RELATED PARTY TRANSACTIONS

During 2005, the Company incurred expenditures of $285 in respect of legal services provided by a firm in which a director of the Company is a partner. The services were conducted in the normal course of operations and are measured at the exchange amount which is established and agreed to by the related parties based on standard rates, time spent and costs incurred.

During 2005 management directors and employees purchased 276,928 common shares for proceeds of $784 and 120,875 flow through shares for proceeds of $515.

COMMON SHARES OUTSTANDING

(thousands)	*Dec 31* 2005	*Dec 31* 2004	*June 30* 2004
Common shares outstanding, end of period	47,988	22,356	21,291
Weighted average shares outstanding, diluted	39,835	21,401	12,559

Prior years' disclosure of shares outstanding has been adjusted to reflect the 1 new common share for 5 old common share consolidation and the 1 for 5 consolidation and conversion of non-voting common shares to voting common shares in May 2005.

There has been no change in the amount of common shares outstanding to the period ended March 22, 2006.

FOURTH QUARTER

During the fourth quarter of 2005, Capitol focused on its development activities at Dixonville and tying in production. Capitol drilled 18.0 gross wells (15.9 net) and incurred capital expenditures of $26,396.

Sales volumes in the fourth quarter of 2005 averaged 1,557 boe per day, and Capitol exited the year at approximately 2,500 boe per day. Revenue was positively impacted by higher production volumes however, the benefits were reduced by a widening crude oil quality differential which averaged $18.20 per barrel in the fourth quarter of 2005 and reached a high of $22.78 per barrel in December.

OUTLOOK

Current production is approximately 2,600 boe per day with approximately 450 boe per day to be tied in and on stream during the second quarter of 2006.

The Company expects to spend at least $55,000 to $60,000 on exploration and drilling activities in 2006. Production is forecasted to average 3,000 to 3,400 boe per day for 2006 with a year end exit rate forecast at approximately 3,950 to 4,350 boe per day.

SUMMARY OF QUARTERLY FINANCIAL AND OPERATIONAL INFORMATION

The following table summarizes selected financial information of the Company for the quarters indicated. On December 2, 2003, the Company terminated its technology business and began investigating oil and gas acquisition opportunities. The Company closed its initial oil and gas acquisition on May 4, 2004 and the acquisition of Tiger on February 28, 2005.

($ thousands except share and per share data)	*Dec 31* 2005	*Sep 30* 2005	*Jun 30* 2005	*Mar 31* 2005	*Dec 31* 2004	*Sep 30* 2004	*Jun 30* 2004	*Mar 31* 2004
Financial								
Production revenue net of royalties and ARTC	5,784	4,345	2,819	1,867	459	404	32	–
Cash flow from (used in) operations *	3,601	2,876	1,176	630	(221)	(25)	(263)	(292)
Per share, basic	0.08	0.07	0.03	0.02	(0.01)	(0.00)	(0.01)	(0.02)
Net income (loss)	9,564	(526)	(1,497)	1,459	(714)	(530)	(906)	(294)
Per share **	0.20	(0.01)	(0.04)	0.05	(0.03)	(0.02)	(0.05)	(0.02)
Capital expenditures	26,396	19,450	6,415	8,568	7,050	1,882	959	42
Corporate and asset acquisitions	–	–	–	49,514	–	–	5,174	–
Net working capital	(10,403)	12,774	(3,743)	1,220	8,367	10,774	12,652	313
Total assets	136,524	121,551	77,286	79,175	29,665	19,925	20,045	468
Shares outstanding *(000's)*	47,988	47,970	40,660	40,580	22,356	21,298	21,291	15,451
Shareholders' equity	114,702	103,309	69,526	69,744	23,012	18,623	18,809	366
Operational								
Sales								
Natural gas *(mcf/d)*	1,320	1,383	797	546	55	66	–	–
Oil *(bbls/d)*	1,337	808	698	490	155	113	12	–
Total *(boe/d)*	1,557	1,039	831	581	164	124	12	–
Average realized prices								
Natural gas *($/mcf)*	11.47	9.04	7.88	5.90	5.68	5.78	–	–
Oil *($/bbl)*	51.47	61.46	51.23	50.97	42.24	46.60	39.64	–
Per boe *($)*	53.93	59.87	50.60	48.53	41.22	46.32	39.64	–
Net wells drilled								
Natural gas	2.5	2.0	0.5	–	–	–	–	–
Oil	12.0	12.0	3.0	0.8	2.4	–	–	–
Dry	1.4	0.9	–	–	–	–	–	–
Total	15.9	14.9	3.5	0.8	2.4	–	–	–

* *non-GAAP measure*
** *basic and diluted*

BUSINESS CONDITIONS AND RISK

The following is a brief summary of business conditions, uncertainties and risks which might impact the financial results of Capitol. Readers are cautioned that the summary is not exhaustive and that these and other risk factors are discussed in further detail throughout this Management's Discussion and Analysis and in our Annual Information Form on file with Canadian securities commissions.

[illegible]

The production forecast and recoverable estimates contained in Capitol's year end reserve evaluation prepared by an independent qualified reserves evaluator ("reserve evaluators") are only estimates and the actual production and ultimate recoverable reserves from the properties may be greater or lesser than the independent estimates of the reserve evaluators.

There are numerous uncertainties inherent in estimating quantities of reserves and cash flows to be derived there-from, including many factors that are beyond the control of Capitol. The reserve and cash flow information set forth herein represent estimates only. The reserves and estimated future net cash flow from the assets of Capitol have been independently evaluated effective December 31, 2005 by the reserve evaluators. These evaluations include a number of assumptions relating to factors such as initial production rates, production decline rates, ultimate recovery of reserves, timing and amount of capital expenditures, marketability of production, future prices of oil and natural gas, operating costs and royalties and other government levies that may be imposed over the producing life of the reserves. These assumptions were based on price forecasts in use at the date the relevant evaluations were prepared and many of these assumptions are subject to change and are beyond the control of Capitol. Actual production and cash flows derived there-from will vary from these evaluations, and such variations could be material. The foregoing evaluations are based in part on the assumed success of exploitation activities intended to be undertaken in future years. The reserves and estimated cash flows to be derived there-from contained in such evaluations will be reduced to the extent that such exploitation activities do not achieve the level of success assumed in the evaluations.

Volatility of oil and natural gas prices

The operational results and financial condition of Capitol will depend on the prices received for oil and natural gas production. Oil and natural gas prices have fluctuated widely during recent years and are determined by supply and demand factors, including weather and general economic conditions as well as conditions in other oil and natural gas regions, which are beyond the Company's control. Any decline in oil and natural gas prices could have an adverse effect on the operations, proved reserves and financial conditions of Capitol, resulting in a reduction of the net production revenue of Capitol and a curtailment of its oil and gas acquisition and development activities.

In addition, bank borrowings which might be made available to Capitol are typically determined in part by the borrowing base of the Company's reserves. A sustained material decline in prices from historical averages could reduce the borrowing base, therefore limiting the bank credit available to Capitol or could require that a portion of such bank debt be repaid.

Operational hazards and other uncertainties

Oil and natural gas exploration operations are subject to all the risks and hazards typically associated with such operations, including hazards such as fire, explosion, blow-outs, and oil spills, each of which could result in substantial damage to oil and natural gas wells, production facilities, other property and the environment or in personal injury. In accordance with industry practice, Capitol is not fully insured against all of these risks, nor are all such risks insurable. Although Capitol maintains liability insurance, in amounts it considers adequate and consistent with industry practice, the nature of these risks is such that liabilities may exceed policy limits, in which event Capitol could incur significant costs that could have a material adverse effect upon its financial condition. Business

interruption insurance may also be purchased for selected facilities, to the extent that such insurance is available.

Although property title reviews are done according to industry standards prior to the purchase of most oil and natural gas producing properties or the commencement of drilling wells, such reviews do not guarantee or certify that an unforeseen defect in the chain of title will not arise to defeat the claim of Capitol which could result in a reduction of the revenue received by Capitol.

Competition

The oil and gas industry is highly competitive. Capitol actively competes with a substantial number of other oil and gas companies that may have greater financial resources for reserve acquisitions, exploration leases, licenses and concessions and skilled industry personnel. As well, Capitol competes for capital to finance its activities. Capitol's competitors include major integrated oil and natural gas companies and numerous other independent oil and natural gas companies and individual producers and operators.

Reliance on operators and key employees

To the extent that Capitol is not the operator of its oil and gas properties, the Company will be dependent on other operators for the timing of activities related to such properties and will largely be unable to direct or control the activities of the operators. In addition, Capitol's success will be largely dependent upon the performance of its management and key employees. Capitol does not have any key man insurance policies, and therefore there is a risk that the death or departure of any member of management or a key employee could have a material adverse effect on Capitol.

Environmental risks

All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of international conventions as well as federal, provincial and municipal laws and regulations. Environmental legislation provides for, among other things, restrictions and prohibitions on spills, releases or emissions of various substances produced in association with oil and gas operations. The legislation also requires that wells and facility sites be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. Compliance with such legislation can require significant expenditures and a breach may result in the imposition of fines and penalties, some of which may be material.

Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liabilities and potentially increased capital expenditures and operating costs. No assurance can be given that environmental laws will not result in a curtailment of production or a material increase in the costs of production, development or exploration activities or otherwise, adversely affecting Capitol's financial condition, results of operations or prospects.

Disclosure controls and procedures

The Company's disclosure controls and procedures have been designed to ensure that information required to be disclosed by the Company is accumulated and communicated to the Company's management as appropriate to allow timely decisions regarding required disclosure. The Company's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of the end of the period covered by the annual filings, that the Company's disclosure controls and procedures are effective to provide reasonable assurance that material information related to the Company is made known to them. It should be noted that while the Company's Chief Executive Officer and Chief Financial Officer believe that the Company's disclosure controls and procedures provide a reasonable level of assurance that they are effective, they do not expect that the disclosure controls and procedures or internal controls over financial reporting will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

CRITICAL ACCOUNTING ESTIMATES AND ACCOUNTING POLICIES

The significant accounting policies used by Capitol are disclosed in Note 2 to Capitol's audited financial statements for the period ended December 31, 2005. Certain accounting policies require management to make appropriate decisions with respect to the formulation of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Discussion about such accounting policies is included in the Management's Discussion and Analysis that accompanies the December 31, 2005, financial statements, to aid the reader in assessing the critical accounting policies and practices of the Company, and the likelihood of materially different results being reported. Capitol's management reviews its estimates regularly. The emergence of new information and changed circumstances may result in actual results or changes to estimated amounts that differ materially from current estimates. Capitol's assessment of significant accounting policies is not meant to be exhaustive. The Company may realize different results from the application of new accounting standards promulgated, from time to time, by various rule-making bodies.

The following discusses the accounting estimates that are critical in determining the reported financial results for the year ended December 31, 2005.

Petroleum and natural gas reserves

The Company engages an independent qualified reserves evaluator to evaluate its reserves on an annual basis with quarterly estimates prepared internally. Reserve determinations involve forecasts based on property performance, future prices, projected future production and the timing of future capital expenditures all of which are subject to uncertainties and interpretations. Reserve estimates have a significant impact on reported financial results as they are the basis for the calculation of depreciation and depletion and many non-GAAP key performance indicators. Revisions can change reported depletion and depreciation as well as earnings; downward revisions could result in an asset impairment.

Full cost accounting

The Company follows the full cost method of accounting as prescribed by the Canadian Institute of Chartered Accountants (CICA) Accounting Guideline 16 "Oil and Gas Accounting – Full Cost", whereby, all costs associated with exploration and development are capitalized, whether successful or not.

The aggregate of capitalized costs, net of certain costs related to unproved properties, and estimated future development costs, is amortized using the unit-of-production method based on estimated proved reserves. Changes in estimated proved reserves or future development costs have a direct impact on depletion and depreciation expense. Certain costs related to unproved properties and major development projects may be excluded from costs subject to depletion until proved reserves have been determined or their value is impaired. Unproved properties are reviewed quarterly to determine if proved reserves should be assigned, at which point they would be included in the depletion calculation, or for impairment, for which any write-down would be charged to depletion and depreciation.

Oil and gas assets are evaluated at least annually to determine that the costs are recoverable and do not exceed the fair value of the properties. The costs are assessed to be recoverable if the sum of the undiscounted cash flows expected from the production of proved reserves and the lower of cost and market of unproved properties exceed the carrying value of the oil and gas assets. If the carrying value of the oil and gas assets is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying value exceeds the sum of the discounted future cash flows from the production of proved and probable reserves and the lower of cost and market of the unproved properties. The cash flows are estimated using future product prices and costs and are discounted using a risk-free rate. By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements could be material. Any impairment would be charged as additional depletion and depreciation expense.

Asset retirement obligation

The Company provides for the estimated abandonment costs of properties using a fair value method. This future estimate is based on estimated costs and technology following current legislation and industry practice. The reported liability is a discounted amount of the estimated future costs. The amount of the liability is affected by factors such as the number of wells, the timing of the expected expenditures, inflation and the discount rate. These estimates will change and the revisions could impact the depletion and depreciation rates.

Stock based compensation

The Company uses fair value accounting for stock-based compensation. Under this method, all equity instruments awarded to employees and the cost of the service received as considerations are measured and recognized based on the fair value of the equity instruments issued. Compensation expense is recognized over the period of related employee service, usually the vesting period of the equity instrument awarded.

Flow-through shares

The Company provides for the future effect on income tax related to flow-through shares as a reduction to share capital and an increase to the future income tax liability or recovery of future taxes when the flow-through share funds are renounced, in accordance with the recommendation of the Emerging Issues Committee of the CICA on flow-through shares (EIC-146).

Income taxes

The Company uses the liability method of tax allocation in accounting for income taxes. Under this method, future income tax liabilities and future income tax assets are determined based on differences between the financial reporting and tax bases of assets and liabilities, and measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. Future tax assets are recorded when it is "more likely than not" the future tax asset will be realized. The determination of the Company's income and other tax liabilities or assets requires interpretation of complex laws and regulations often involving multiple jurisdictions. All tax filings are subject to audit and potential reassessment after lapse of considerable time. Accordingly, the actual income tax liability or asset may differ significantly from the liability estimated or recorded.

Other estimates

The accrual method of accounting requires management to incorporate certain estimates including estimates of revenues, royalties and production costs as at a specific reporting date, but for which actual revenues and costs have not yet been received; and estimates on capital projects which are in progress or recently completed where actual costs have not been received at a specific reporting date. The Company ensures that the individuals with the most knowledge of the activity are responsible for the estimate. These estimates are then reviewed for reasonableness and past estimates are compared to actual results in order to make informed decisions on future estimates.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements regarding Capitol Energy Resources Ltd., including management's assessments of future plans and operations, may constitute forward-looking statements under applicable securities laws and necessarily involve known and unknown risks and uncertainties, most of which are beyond Capitol's control. These risks may cause actual financial and operating results, performance, levels of activity and achievements to differ materially from those expressed in, or implied by, such forward-looking statements.

Such factors include, but are not limited to: the impact of general economic conditions in Canada and the United States; industry conditions including changes in laws and regulations including adoption of new environmental laws and regulations, and changes in how they are interpreted and enforced; competition; the lack of availability of qualified personnel; fluctuations in commodity prices; the results of exploration and development drilling and related activities; imprecision in reserve estimates; the production and growth potential of Capitol's various assets; fluctuations in foreign exchange or interest rates; the ability to access sufficient capital from internal and external sources; and obtaining required approvals of regulatory authorities. The foregoing important factors are not exhaustive. Many of these risk factors are discussed in further detail throughout this Management's Discussion and Analysis and in our Annual Information Form on file with Canadian securities commissions. Readers are also referred to the risk factors described in other documents that we file from time to time with securities regulatory authorities.

Accordingly, Capitol gives no assurance nor makes any representations or warranty that the expectations conveyed by the forward-looking statements will prove to be correct and actual results may differ materially from those anticipated in the forward looking statements. Capitol undertakes no obligation to publicly update or revise any forward-looking statements.

Management has prepared the accompanying financial statements of Capitol Energy Resources Ltd., in accordance with Canadian generally accepted accounting principles. Financial and operating information presented throughout this Annual Report is consistent with that shown in the financial statements.

Management is responsible for the integrity of the financial information. Internal control systems are designed and maintained to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and to produce reliable accounting records for financial reporting purposes.

KPMG LLP was appointed by the Company's shareholders' to perform an examination of the corporate and accounting records so as to express an opinion on the financial statements. Their examination included such tests and procedures, as they considered necessary, to provide a reasonable assurance that the financial statements are presented fairly in accordance with Canadian generally accepted accounting principles.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board exercises this responsibility through the Audit Committee, with assistance from the Reserve Committee regarding the annual evaluation of our petroleum and natural gas reserves. The Audit Committee meets regularly with management and the independent auditors to ensure that management's responsibilities are properly discharged, to review the financial statements and recommend that the financial statements be presented to the Board of Directors for approval. The Audit Committee also considers the independence of the external auditors and reviews their fees. The external auditors have access to the Audit Committee without the presence of management.

"Signed"

R.L. (MONTY) BOWERS
President & Chief Executive Officer

"Signed"

DOUG DEARING
Vice President, Finance & Chief Financial Officer

CALGARY, CANADA MARCH 22, 2006

We have audited the balance sheets of Capitol Energy Resources Ltd., as at December 31, 2005 and 2004 and June 30, 2004 and the statements of operations, and retained earnings and cash flows for the year ended December 31, 2005, the six month period ended December 31, 2004 and the year ended June 30, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005, and 2004 and June 30, 2004 and the results of its operations and its cash flows for the year ended December 31, 2005, the six month period ended December 31, 2004 and the year ended June 30, 2004, in accordance with Canadian generally accepted accounting principles.

KPMG LLP

KPMG LLP
Chartered Accountants

CALGARY, CANADA MARCH 22, 2006

as at (in thousands of dollars)	*Dec 31* 2005	*Dec 31* 2004	*June 30* 2004
ASSETS			
Current			
Cash and cash equivalents	$ 4,232	$ 14,067	$ 13,489
Accounts receivable *(note 3)*	5,251	551	186
Other current assets	264	114	68
	9,747	14,732	13,743
Property and equipment *(note 4)*	116,232	14,933	6,302
Future tax asset *(note 7)*	10,545	–	–
	$ 136,524	$ 29,665	$ 20,045
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current			
Accounts payable and accrued liabilities	$ 20,150	$ 6,365	$ 1,091
Office lease inducements	31	29	–
Asset retirement obligation *(note 6)*	1,641	259	145
	21,822	6,653	1,236
Shareholders' equity			
Share capital *(note 8)*	105,864	28,178	23,314
Contributed surplus *(note 8)*	6,203	1,199	616
Retained earnings (deficit)	2,635	(6,365)	(5,121)
	114,702	23,012	18,809
	$ 136,524	$ 29,665	$ 20,045

Commitments *(note 13)*

Subsequent events *(note 15)*

See accompanying notes to financial statements.

Approved on behalf of the Board:

R.L. (MONTY) BOWERS
Director

SHELDON REID
Director

(in thousands of dollars except per share data)	*year ended Dec 31* 2005	*six months ended Dec 31* 2004	*year ended June 30* 2004
REVENUES			
Petroleum and natural gas	$ 19,803	$ 1,151	$ 44
Royalties, net of Alberta Royalty Tax Credit	(4,988)	(289)	(12)
Interest	181	115	32
	14,996	977	64
EXPENSES			
Production	1,354	184	8
Transportation	1,640	75	3
General and administrative	3,246	964	665
Stock based compensation *(note 9)*	5,025	583	616
Depletion, depreciation and accretion	7,910	415	29
Interest	[illegible]	–	–
	19,560	2,221	1,321
Net loss before taxes	(4,564)	(1,244)	(1,257)
Current income taxes *(note 7)*	88	–	–
Recovery of future income taxes *(note 7)*	(13,652)	–	–
NET INCOME (LOSS) FROM CONTINUING OPERATIONS	9,000	(1,244)	(1,257)
Loss from discontinued operations *(note 11)*	–	–	(1,083)
NET INCOME (LOSS) FOR THE PERIOD	9,000	$ (1,244)	$ (2,340)
Deficit, beginning of period	(6,365)	(5,121)	(80,562)
Reduction in deficit *(note 10)*	–	–	77,781
RETAINED EARNINGS (DEFICIT), END OF PERIOD	2,635	$ (6,365)	$ (5,121)
Net income (loss) per share from continuing operations, basic and diluted	0.23	$ (0.06)	$ (0.10)
Net income (loss) per share, basic and diluted	$ 0.23	$ (0.06)	$ (0.19)
Weighted average number of shares outstanding *(000's) (note 14)*			
basic	39,617	21,401	12,559
diluted	39,835	21,401	12,559
Shares issued and outstanding *(note 8)*	47,988	22,356	21,291

See accompanying notes to financial statements.

in thousands of dollars	*year ended Dec 31* 2005	*six months ended Dec 31* 2004	*year ended June 30* 2004
OPERATING ACTIVITIES			
Net income (loss) from continuing operations	$ 9,000	$ (1,244)	$ (1,257)
Depletion, depreciation, and accretion	7,910	415	29
Stock based compensation	5,025	583	616
Recovery of future income taxes	(13,652)	–	–
Expenditures on abandonments	(110)	–	–
	8,173	(246)	(612)
Changes in non-cash working capital	(1,718)	38	(152)
	6,455	(208)	(764)
FINANCING ACTIVITIES			
Issuance of subscription receipts *(note 8)*	50,000	–	–
Issuance of shares	35,519	5,230	24,754
Share issue costs *(note 8)*	(4,994)	(366)	(1,791)
Exercise of warrants *(note 8)*	198	–	545
Exercise of options	49	–	306
Office lease inducements	2	29	–
Convertible debenture	–	–	200
Restricted cash	–	–	75
Repayment of government assistance	–	–	(164)
	80,774	4,893	23,925
INVESTING ACTIVITIES			
Acquisition of Tiger shares *(note 3)*	(49,514)	–	–
Cash acquired on acquisition of Tiger *(note 3)*	3,430	–	–
Property plant and equipment expenditures	(60,829)	(8,932)	(1,012)
Asset acquisition	–	–	(5,174)
Change in non-cash working capital	9,849	4,825	987
Cash distributed under Plan of Arrangement	–	–	(2,937)
Proceeds on sale of assets	–	–	2
	(97,064)	(4,107)	(8,134)
Funds used in discontinued operations *(note 11)*	–	–	(1,955)
(Decrease) increase in cash and cash equivalents	(9,835)	578	13,072
Cash and cash equivalents, beginning of period	14,067	13,489	417
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 4,232	$ 14,067	$ 13,489

Supplemental cash flow information *(note 14)*

See accompanying notes to financial statements.

NOTE 1: NATURE OF BUSINESS

Capitol Energy Resources Ltd. ("Capitol" or the "Company") is a public company engaged in the exploration, development and production of crude oil and natural gas in Alberta. Capitol was formed on December 1, 2003, through a Plan of Arrangement (the "Plan") of Cell-Loc Inc. a public technology company. On December 1, 2003, the shareholders of Cell-Loc Inc. voted to accept an agreement Cell-Loc Inc. had reached with a private investment partnership to complete concurrent equity financing, asset sale and asset distribution transactions and changed its name to Capitol Energy Resources Ltd. (the "Agreement"). On December 2, 2003, the Court of Queen's Bench of Alberta approved the Plan (note 10) and the Company exited its technology business. Amounts relating to the period prior to December 2, 2003 have been reported as discontinued operations (note 11).

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES

a) Basis of presentation

The financial statements include the accounts of Capitol and have been prepared in Canadian dollars in accordance with Canadian generally accepted accounting principles.

b) Measurement uncertainty

The preparation of the financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingencies, if any, as at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Amounts recorded for depletion, depreciation and asset retirement obligations and amounts used for the ceiling test calculation are based on estimates of oil and natural gas reserves, future costs required to develop those reserves, commodity prices and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty.

c) Cash and cash equivalents

Cash and cash equivalents consist of cash balances with banks and short-term investments with original maturities of less than three months. The fair value of cash and cash equivalents approximates the amounts shown in the financial statements.

d) Petroleum and natural gas properties

i) Capitalized costs

The Company follows the full cost method of accounting whereby all costs relating to the acquisition of, exploration for and development of oil and gas reserves are capitalized in a single Canadian cost center. Such costs include; lease acquisition, lease rentals on undeveloped properties, geological and geophysical, drilling both productive and non-productive wells, production equipment and facilities, and general and administrative costs that are directly related to exploration and development activities.

ii) Depletion and depreciation

All costs of acquisition, exploration and development of oil and gas reserves, associated tangible plant and equipment costs (net of salvage value), and estimated costs of future development of proven undeveloped reserves are depleted and depreciated by the unit of production method based on estimated gross proven reserves as determined by independent engineers.

Costs of unproved properties are initially excluded from oil and gas properties for the purpose of calculating depletion. When proven reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to costs subject to depletion.

The relative volumes of oil and natural gas reserves and production are converted to equivalent barrels of oil on a 6 mcf to 1 boe basis.

Depreciation of office furniture and equipment is provided at rates ranging from 20% to 50%.

iii) Ceiling test limitations

The Company places a limit on the net carrying value of capital assets to an ultimate recoverable amount (the ceiling test). The ceiling test is a cost recovery test whereby the capitalized costs, less accumulated depletion and asset retirement obligation and the lower of cost and market value of unproved land, are limited to an amount equal to estimated undiscounted future net revenues from proved reserves, less estimated production costs and future development costs. Future net revenues are estimated using forecast prices as at the balance sheet date.

e) Joint operations

Portions of the Company's oil and gas exploration and development activities are conducted jointly with industry partners and accordingly the financial statements reflect only the Company's proportionate interest in such activities.

f) Asset retirement obligations

The fair value of the liability for the Company's asset retirement obligation is recorded in the period in which it is incurred, discounted to its present value using the Company's credit adjusted risk-free interest rate and the corresponding amount is recognized by increasing the carrying amount of the related long-lived asset.

The liability is accreted each period and the capitalized cost is depleted or depreciated over the useful life of the related asset.

g) Income taxes

The Company uses the liability method of tax allocation in accounting for income taxes. Under this method, future income tax liabilities and future income tax assets are determined based on differences between the financial reporting and tax bases of assets and liabilities, and measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. Future tax assets are recorded when it is "more likely than not" the future tax asset will be realized.

h) Leasehold inducements

Leasehold inducements are accounted for as a reduction of rental expense over the term of the related lease.

i) Revenue recognition

Oil and natural gas sales are recognized as revenue when the commodities are delivered to purchasers.

Revenues, expenses and sales volumes from acquisitions are recorded for financial statement purposes from the date the transaction closes. Revenues, expenses and adjustments from the effective date to the closing date are recorded as adjustments to the purchase price.

j) Stock based compensation

The Company uses the fair value method of accounting for stock-based compensation. Under this method, all equity instruments awarded to employees and the cost of the service received as considerations are measured and recognized based on the fair value of the equity instruments issued. Compensation expense is recognized over the period of related employee service, usually the vesting period of the equity instrument awarded.

k) Flow-through shares

The Company may finance a portion of its exploration activities through the issuance of flow-through common shares. Under the terms of the flow-through agreement, the resource expenditure deductions for income tax purposes are renounced to

(in thousands of dollars unless otherwise noted)

investors in accordance with the appropriate income tax legislation. The Company provides for the future effect on income tax, related to flow-through shares, as a reduction to share capital and an increase to the future income tax liability or recovery of future taxes if previously unrecognized future tax assets exist, when the flow-through share funds are renounced, in accordance with the March 19, 2004, recommendation of the Emerging Issues Committee of the CICA on flow-through shares.

l) Per share amounts

Basic and diluted earnings and net loss per share are calculated using the weighted average number of voting and non-voting common shares outstanding during the year.

The Company uses the treasury stock method to determine the dilutive effect of stock options and warrants. Diluted calculations reflect the weighted average incremental common shares that would be issued upon exercise of dilutive options and warrants assuming the proceeds would be used to repurchase common shares at the average market price for the period. Anti-dilutive options and warrants are excluded from the calculation.

m) Comparative figures

Certain comparative figures from the prior year have been reclassified to conform to the current year presentation.

NOTE 3: ACQUISITION OF TIGER ENERGY LIMITED

On February 28, 2005, Capitol acquired all of the common shares of Tiger Energy Limited ("Tiger"), a Calgary based, private exploration company active in west central Alberta for cash consideration of $49,352 subject to working capital adjustments pursuant to a plan of arrangement. Included in accounts receivable at December 31, 2005 is $282 due from Ridgeback in respect of working capital adjustments.

Immediately prior to the acquisition, Tiger sold certain oil and gas assets to an affiliated company, Ridgeback Exploration Ltd. ("Ridgeback").

Tiger was wound up into Capitol immediately upon closing. The business combination has been accounted for using the purchase method with results of operations of Tiger included in the financial statements from the date of acquisition.

The calculation of the purchase price and the allocation to assets and liabilities is shown below.

Cash paid for common shares of Tiger Energy Limited	$ 49,352
Transaction costs	162
Total purchase price	$ 49,514
Fair value of assets and liabilities assumed	
Property, plant, and equipment	$ 47,251
Current assets (including $3,430 of cash)	6,819
Current liabilities	(4,193)
Asset retirement obligation acquired	(363)
Total assets and liabilities assumed	$ 49,514

Future income taxes payable of $11,089 resulting from temporary differences between allocated values and tax values for Tiger's assets and liabilities were eliminated through the recognition of previously unrecognized tax assets of Capitol.

(in thousands of dollars unless otherwise noted)

NOTE 4: PROPERTY AND EQUIPMENT

as at	*Dec 31* 2005	*Dec 31* 2004	*June 30* 2004
Oil and natural gas properties and production equipment	$ 124,208	$ 15,212	$ 6,270
Administrative	321	160	61
	124,529	15,372	6,331
Accumulated depreciation and depletion	(8,297)	(439)	(29)
	$ 116,232	$ 14,933	$ 6,302

General and administrative expenses of $710 related to geological, geophysical and engineering activities were capitalized in 2005 (December 31, 2004 – $Nil; June 30, 2004 – $Nil)

All costs are subject to depletion and depreciation at December 31, 2005, with the exception of unproved property costs of $4,740 (December 31, 2004 – $53; June 30, 2004 – $41).

Future expenditures totaling $61,165 (December 31, 2004 – $6,459; June 30, 2004 – $1,884) in respect of capital expenditures to develop proven reserves and asset retirement costs associated with proven undeveloped reserves have been included in costs subject to depletion and depreciation at December 31, 2005.

The benchmark prices used in the ceiling test evaluation of the Company's crude oil and natural gas reserves at as forecast by Capitol's independent qualified reserves evaluator at December 31, 2005 were:

			oil		*natural gas*
	WTI ($US/bbl)	*Edmonton light crude ($C/bbl)*	*Capitol realized price ($C/bbl)*	*AECO Spot ($C/GJ)*	*Capitol realized price ($C/mcf)*
2006	57.50	66.60	53.43	10.05	10.66
2007	55.40	64.20	52.29	9.05	9.60
2008	52.50	60.70	50.18	8.05	8.53
2009	49.50	57.20	48.00	7.00	7.41
2010	46.90	54.10	45.41	6.55	6.91

Escalating thereafter at approximately 2.5%

NOTE 5: BANK LOAN

At December 31, 2005, the Company had a revolving credit facility to a maximum of $23,500. The revolving credit facility is repayable on demand and bears interest at the bank prime rate plus 0.25%, calculated daily and payable monthly.

At December 31, 2005, the Company had a non-revolving development facility to a maximum of $7,000. The non-revolving credit facility is repayable at $200 per month or on demand and bears interest at the bank prime rate plus 0.75%, calculated daily and payable monthly. During 2005, the Company borrowed and repaid $5,000 on the non-revolving development facility.

The revolving and non-revolving development facilities are secured by a first floating charge debenture for $75,000 over the Company's oil and gas properties and are subject to an interim review by April 30, 2006.

At December 31, 2005, the Company had no amounts drawn against its bank lines.

(in thousands of dollars unless otherwise noted)

NOTE 6: ASSET RETIREMENT OBLIGATION

	year ended Dec 31 2005	six months ended Dec 31 2004	year ended June 30 2004
Balance, beginning of period	$ 259	$ 145	$ –
Liabilities incurred	877	108	145
Liabilities settled	(110)	–	–
Change in estimated future cash flows	200	–	–
Accretion expense	52	6	–
Acquired on business combination *(note 3)*	363	–	–
Balance, end of period	$ 1,641	$ **259**	$ **1,45**

The Company's asset retirement obligation results from net ownership interest in oil and natural gas assets including well sites, gathering systems and processing facilities. The Company estimates at December 31, 2005, the total undiscounted amount of cash flows required to settle the asset retirement obligations (ARO), which will be incurred after 2020, will be approximately $4,346. In calculating the Company's future asset retirement obligation an annual credit adjusted risk free interest rate of 7.0% and an annual inflation rate of 2.5% were used (December 31, 2004 – interest rate of 7.0%, inflation rate of 2.2%; June 30, 2004 – interest rate of 7.0%, inflation rate of 2.2%).

NOTE 7: INCOME TAXES

The provision for income taxes recorded in the financial statements differs from the amount expected by applying applicable statutory rates. Differences are as a result of the following:

	year ended Dec 31 2005	six months ended Dec 31 2004	year ended June 30 2004
Net loss from continuing operations before taxes	$ (4,564)	$ (1,244)	$ (1,257)
Statutory Canadian corporate tax rate	37.62%	38.62%	38.62%
Anticipated tax recovery	(1,717)	(480)	(485)
Non-deductible crown payments net of ARTC	848	26	–
Resource allowance	(937)	15	49
Stock-based compensation	1,591	222	207
Expiry of non-capital losses	168	–	160
Change in enacted rate	–	–	745
Other	208	(75)	158
Change in valuation allowance	(14,113)	292	(834)
Recovery of future income taxes	$ 13,652	$ –	$ –

(in thousands of dollars unless otherwise noted)

For the year ended December 31, 2005, a future income tax recovery of $13,652 was recorded in Capitol's income statement (December 31, 2004 – $Nil; June 30, 2004 – $Nil). The future tax recovery is due to the elimination of future taxes of $3,816 recorded on the renunciation of flow through share expenditures and $9,836 was due to the recognition of future income tax assets as noted below.

For the year ended December 31, 2005 the Company recorded current taxes of $88 in relation to large corporation's tax (December 31, 2004 – $Nil; June 30, 2004 – $Nil).

The components of the Company's future income tax assets and liabilities are as follows:

as at	*Dec 31* 2005	*Dec 31* 2004	*June 30* 2004
Future income tax liabilities			
Net book value of property and equipment in excess of tax deductions	$ (5,089)	$ –	$ –
Future income tax assets			
Tax deductions in excess of net book value of capital assets	–	10,608	10,632
Asset retirement obligation	552	87	–
Non-capital loss carry-forwards	12,305	13,158	12,876
Scientific research and development expenditures	754	754	754
Share issue costs	1,812	569	648
Other	248	63	37
Net future income tax assets	10,582	25,239	24,947
Valuation allowance	(37)	(25,239)	(24,947)
Future income tax asset	$ 10,545	$ –	$ –

As a result of significant increases in estimated future cash flows from Capitol's oil and gas properties, and the assessment that Capitol will be able to utilize its tax deductions on a more likely than not basis, a future income tax asset of $10,545 was recorded at December 31, 2005 (December 31, 2004 – $Nil; June 30, 2004 – $Nil).

In conjunction with the business combination with Tiger (note 4), the Company recognized a future income tax benefit of approximately $11,089 to eliminate future tax on the excess of allocated values over Tiger tax basis.

Pursuant to flow through shares issued in 2005, the Company is required to spend $5,517 on qualifying Canadian exploration expenditures by December 31, 2006. As at December 31, 2005, the Company had incurred approximately $1,250 of the expenditures.

The Company had approximately $147,000 of available tax deductions, including non capital losses of approximately $36,600, at December 31, 2005 for application against future taxable income.

(in thousands of dollars unless otherwise noted)

The Company's non capital losses expire on June 30 of the following years:

	amount
2007	$ 4,200
2008	19,200
2009	6,900
2010	1,800
2013	900
2014	3,600
Non-capital losses available	$ 36,600

NOTE 8: SHARE CAPITAL

a) Authorized

Unlimited number of voting common shares without par value.

Unlimited number of preferred shares to be issued in series.

b) Share consolidation and conversion of non-voting common shares

At the Annual General and Special Meeting of voting common shareholders held on May 4, 2005, a resolution was passed by a majority to consolidate the Company's voting common shares on the basis of one new common share for each five shares currently outstanding. This resulted in the consolidation of 156,954,432 voting common shares outstanding effective May 16, 2005 into 31,390,886 new voting common shares. The shareholders also approved the conversion of the Company's outstanding non-voting common shares into voting common shares on the basis of one post-consolidated voting common share for each five non-voting common shares.

At the Special Meeting of non-voting common shareholders held on May 4, 2005, a resolution to approve the conversion of the issued and outstanding non-voting common shares into voting common shares, on the basis of one voting common share (on a post-consolidated basis) for each five non-voting common shares, and to delete the non-voting common shares as an authorized class of shares of the Company was approved by 100% of the shareholders present at the meeting. This resulted in the conversion of 45,943,743 non-voting common shares outstanding effective May 16, 2005 into 9,188,749 new voting common shares and the cancellation of the non-voting common shares as an authorized class of share capital.

All information related to common shares, stock options, share warrants and per share amounts has been restated to give effect to the share consolidation in May 2005.

(thousands of dollars unless otherwise noted)

c) Issued and outstanding

	voting	non voting	amount
Outstanding at June 30, 2003	**6,627,379**	–	$ **87,834**
Issued on exercise of options	7,400	–	16
Severance settlement	9,020	–	23
Expenses paid by issuance of shares	24,061	–	61
Issued on exercise of options	146,168	–	290
Issued on exercise of warrants	196,407	–	545
Issue of shares for cash *(note 10d)*	2,245,819	–	4,700
Distribution of CLTI shares by return of capital *(note 10)*	–	9,188,749	(10,835)
Cancellation of old common shares *(note 10e)*	(7,010,434)	–	–
Issue of new common shares *(note 10e)*	3,505,217	–	–
Deficit reduction *(note (10f)*	–	–	(77,781)
Issued on conversion of debenture *(note 10b)*	486,577	–	200
Costs of Plan of Arrangement	–	–	(472)
Issued to dissenting warrant holder	25,000	–	100
Private placement – common shares	3,240,000	–	10,044
Private placement – flow-through shares	2,600,000	–	10,010
Share issue costs	–	–	(1,421)
Outstanding at June 30, 2004	**12,102,614**	**9,188,749**	$ **23,314**
Private placements – flow-through shares	1,064,362	–	5,230
Share issue costs	–	–	(366)
Outstanding at December 31, 2004	**13,166,976**	**9,188,749**	$ **28,178**
Issued on conversion of subscription receipts	18,181,818	–	50,000
Tax effect of flow-through shares	–	–	(5,124)
Issued on exercise of warrants	44,092	–	198
Issued on exercise of options	13,967	–	70
Non-voting shares conversion to voting shares	9,188,749	(9,188,749)	–
Private placements – flow-through shares	940,875	–	5,517
Private placement – common shares	6,452,000	–	30,002
Share issue costs	–	–	(4,994)
Tax effect of share issue costs	–	–	2,017
Outstanding at December 31, 2005	47,988,477	–	$ 105,864

(in thousands of dollars unless otherwise noted)

d) Flow-through shares

During the year ended December 31, 2005, the Company issued common shares on a flow-through basis for gross proceeds of $5,517 to finance certain oil and gas expenditures to be incurred in 2005 and 2006.

In accordance with Canadian accounting standards the foregone tax benefits will be reflected in the financial statements as future income taxes and a reduction in share capital upon renouncement to shareholders in February of 2006.

At December 31, 2005, the Company had spent $1,250 in respect of its 2005 flow through shares and had a commitment to spend an additional $4,267 on eligible Canadian exploration expenditures prior to December 31, 2006.

e) Warrants

At December 31, 2005, 35,000 warrants to purchase Company shares were outstanding at the following expiry dates and exercise prices:

expiry date	*warrants*		*exercise price*
October 5, 2006	12,500	$	4.10
December 21, 2006	12,500		23.20
March 28, 2007	10,000		19.10
Outstanding at December 31, 2005	35,000	$	15.21

During 2005, 44,092 warrants were exercised for proceeds of $198 and 150,351 warrants expired unexercised.

f) Shares in escrow

On June 4, 2005, a total of 683,100 voting common shares (3,415,498 voting common shares on a pre-consolidated basis) and 2,297,187 non-voting common shares (11,485,933 non-voting common shares on a pre-consolidated basis) were released from escrow pursuant to an escrow agreement dated December 1, 2003, between the Company, the Company's transfer agent and certain shareholders pursuant to the policies of the TSX Venture exchange.

On May 16, 2005, management and directors received 4,504,576 new common shares in exchange for 4,504,576 non-voting common shares (22,522,884 non-voting common shares on a pre-consolidated basis). The shares are subject to a one year hold period from May 4, 2005, the date of annual general meeting approving the consolidation and conversion of the non-voting common shares to voting common shares, pursuant to a voluntary escrow agreement.

g) Contributed surplus

The following table summarizes changes to contributed surplus for the periods.

as at		*Dec 31* 2005		*Dec 31* 2004		*June 30* 2004
Contributed surplus, beginning of period	$	1,199	$	616	$	–
Amortization of new options granted		2,254		161		616
Amortization of previously issued options		2,771		422		–
Exercised options		(21)		–		–
Balance, end of period	$	6,203	$	1,199	$	616

(in thousands of dollars unless otherwise noted)

NOTE 9: STOCK OPTIONS

The following tables summarize information about options to purchase common shares.

	number	weighted average exercise price
Outstanding at June 30, 2003	621,842	$ 32.10
Granted	915,300	3.50
Exercised	(153,568)	2.34
Cancelled	(295,650)	65.01
Cancelled in accordance with Plan of Arrangement	(259,458)	55.90
Issued in accordance with Plan of Arrangement	129,729	111.80
Outstanding at June 30, 2004	958,195	$ 3.74
Granted	208,000	3.89
Outstanding at December 31, 2004	1,166,195	$ 3.82
Granted	2,241,000	4.81
Exercised	(13,967)	3.50
Forfeited	(27,933)	3.50
Outstanding at December 31, 2005	3,365,295	$ 4.48

	outstanding options			exercisable options	
range of exercise price	*number*	*weighted average exercise price*	*weighted average years to expiry*	*number*	*weighted average exercise price*
$3.40 – $4.99	1,780,991	$ 3.86	3.77	965,191	$ 3.76
$5.00 – $6.00	1,563,404	5.03	4.29	524,737	5.03
$15.50 – $20.50	20,900	15.95	1.37	20,900	15.95
Total	3,365,295	$ 4.48	4.00	1,510,828	$ 4.37

Options granted have been accounted for using the fair value method. The fair value of common share options granted during the year ended December 31, 2005, is estimated to be $3.02 per option, $6,762 in total (December 31, 2004 – $2.33 per option, $485 in total; June 30, 2004 – $1.53 per option, $1,402 in total) as at the date of grant using the Black-Scholes option pricing model and the following weighted average assumptions:

	year ended Dec 31 2005	*six months ended Dec 31* 2004	*year ended June 30* 2004
Risk free interest rate	5.00%	5.00%	3.50%
Expected life	5 years	5 years	5 years
Expected volatility	73%	67%	40%
Expected dividend yield	0%	0%	0%

(in thousands of dollars unless otherwise noted)

The Company's options vest one third on their grant date, one third on the first anniversary date of the options and one third on the second anniversary date of the options. Accordingly, one third of the estimated fair value of the options is expensed on the grant date with the balance amortized to stock based compensation expense over the balance of the vesting period on a straight-line basis. For the year ended December 31, 2005, stock based compensation expense of $5,025 (December 31, 2004 – $583; June 30, 2004 – $616) was recorded.

NOTE 10: REORGANIZATION

In accordance with the Plan involving Capitol, Cell-Loc Location Technologies Inc. ("CLTI") and other parties approved by the Court of Queen's Bench of Alberta on December 2, 2003, the following transactions occurred:

a) Capitol's technology business and related material assets and rights and certain liabilities and obligations of the Company were transferred to CLTI for consideration of 35,052,169 common shares of CLTI.

Net assets transferred:		
Cash	$	2,937
Other current assets		82
Network assets		7,769
Interest in assets held by supplier		3,256
Capital assets		474
Intellectual property and other intangible assets		379
Current liabilities		(68)
Long-term liabilities		(3,994)
Consideration received		
35,052,169 common shares of CLTI	$	10,835

At the time of the transfer, Capitol and CLTI were related parties. The transfer was recorded based on the carrying value of the net assets transferred.

b) Contribution of $200 by private investors in consideration of non interest bearing, unsecured, convertible, redeemable debentures. The debentures were convertible into common shares of Capitol at $0.415 per share.

c) The cancellation of existing stock options and replacement with one-half of one Capitol option for each existing option held. The exercise price of the replacement options was set at twice the exercise price of the cancelled options with the same terms as the cancelled options.

d) As consideration for the issuance of 2,245,819 voting common shares and 9,188,749 non-voting shares $4,700 was invested in the Company.

e) In accordance with the Plan, subsequent to completion of the asset transfer, one new common share (the "New Common Shares") of the Company was exchanged with the Company shareholders for each two common shares of Cell-Loc held.

f) The stated share capital of the New Common Shares was reduced to one dollar by the application of a $77,781 deficit.

g) Warrants outstanding at the date of the Plan were cancelled and replaced with one-half of a new warrant of the Company for each cancelled warrant. The exercise price of the new warrants was set at twice the exercise price of the cancelled warrants. Note all share amounts relating to Capitol have been re-stated to reflect the share consolidation in May 2005

(in thousands of dollars unless otherwise noted)

NOTE 11: DISCONTINUED OPERATIONS

On December 2, 2003, the Company exited its wireless location business. These operations have been accounted for as discontinued operations for the year ended June 30, 2004. There were no amounts in respect of discontinued operations for the year ended December 31, 2005 or for the period ended December 31, 2004.

STATEMENT OF OPERATIONS FROM DISCONTINUED OPERATIONS		*year ended June 30* 2004
Revenue		
Miscellaneous	$	50
Other income		28
		78
Operating expenses		
Operations		107
Marketing and business development		6
General and administrative and other		1,062
Loss on sale of assets		7
Foreign exchange		(9)
Depreciation and amortization		268
		1,441
Other expenses (gains)		
Interest expense		120
Gain on settlement of trade liabilities		(400)
		(280)
Net (loss) before income tax		(1,083)
Income tax		–
Net (loss) from discontinued operations	$	(1,083)
Net (loss) per share from discontinued operations, basic and diluted	$	(0.09)

(in thousands of dollars unless otherwise noted)

STATEMENT OF CASH FLOWS FROM DISCONTINUED OPERATIONS		*year ended June 30* 2004
Net (loss) from discontinued operations	$	(1,083)
Non-cash items		
Depreciation and amortization		268
Interest capitalized		92
Gain on settlement of trade liabilities		(400)
Expenses paid by issuance of shares		84
Loss on sales of assets		7
Unrealized foreign exchange		(5)
		(1,037)
Changes in non-cash working capital		(918)
Funds used in discontinued operations	$	(1,955)

NOTE 12: RELATED PARTY TRANSACTIONS

a) Services

During 2005, the company recorded general and administrative expenses of $131, share issue costs of $65 and transaction costs associated with the acquisition of Tiger of $89 in respect of legal services provided by a firm in which a director of the Company is a partner ($36, $54 and $Nil respectively for the period ended December 31, 2004; $245, $38 and $Nil respectively for the year ended June 30, 2004). At December 31, 2005, a payable of $36 existed ($77 at December 31, 2004; $45 at June 30, 2004).

During 2004, a Director of the Company was the President of CLTI. CLTI was paid $56 for the year ended June 30, 2004 for administrative services while the Company shared its office premises.

The services were conducted in the normal course of operations and are measured at the exchange amount which is established and agreed to by the related parties based on standard rates, time spent and costs incurred.

b) Shares

Of the 18,181,818 common shares issued with the private placement of subscription receipts on February 28, 2005 and the private placement of 6,452,000 common shares on September 29, 2005, management, directors and employees purchased 276,928 shares for proceeds of $784. Of the 3,240,000 common shares issued under a private placement in the year ended June 30, 2004, directors and employees purchased 32,258 common shares for $32.

Of the 7,392,875 flow through shares issued during 2005, employees and directors purchased 120,875 shares for $515 (December 31, 2004 – 74,362 flow through shares for $280; June 30, 2004 – 43,376 flow through shares purchased for $167).

(in thousands of dollars unless otherwise noted)

NOTE 13: COMMITMENTS

	2006	2007	2008	2009	2010	*thereafter*	*total*
Capital commitments	750	–	–	–	–	–	750
Office lease	252	261	268	246	–	–	1,027
Total	1,002	261	268	246	–	–	1,777

The Company has contracted two drilling rigs until June 1, 2006. The minimum cost is $5 per day until March 15, 2006 per each rig not in use. The Company has the option to release one or both rigs with nominal notice.

NOTE 14: SUPPLEMENTARY INFORMATION

a) Per share amounts

The following table summarizes the common shares used in calculating net loss and cash flow per share:

(thousands)	*year ended Dec 31* 2005	*six months ended Dec 31* 2004	*year ended June 30* 2004
Weighted average common shares outstanding – basic	39,617	21,401	12,559
Effect of dilutive securities	218	–	–
Weighted average common shares outstanding – diluted	39,835	21,401	12,559

The amounts above have been restated to reflect the effect of the common share consolidation in May 2005.

b) Supplementary cash flow information from continuing operations

	year ended Dec 31 2005	*six months ended Dec 31* 2004	*year ended June 30* 2004
Interest paid	122	–	–
Income taxes paid	57	–	–

NOTE 15: SUBSEQUENT EVENTS

On March 15, 2006 the Company's revolving credit facility (note 5) was increased to $30,000 from $23,500 and the Company's non-revolving credit facility was increased to $20,000 from $7,000. The revised credit facilities will be subject to an interim review by July 1, 2006.

JIM NIEUWENBURG
Chairman
Mr. Nieuwenburg is the Chairman of the Board of Directors. His extensive background in the oil and gas industry includes petroleum engineering, business development, executive management and corporate governance. He is currently Chairman of C1 Energy Ltd (since 2003) and served as President and CEO of Petromet Resources Limited (1998 - 2001) until the company was successfully sold. Prior to that, Mr. Nieuwenburg served as Vice President, Asset Management of Norcen Energy Resources Limited (1997 - 1998) until it was successfully sold. Mr. Nieuwenburg held various positions with increasing responsibility with Amoco Energy Group, North America for 17 years (1980 - 1997), with his last position being General Manager, Business Development. Mr. Nieuwenburg also serves on the Boards of Fairborne Energy Trust, NAV Energy Trust, Rifco Inc. and Verenex Energy Inc

R. L. (MONTY) BOWERS
President & CEO, Director
Mr. Bowers is President, CEO and a Director of Capitol Energy Resources Ltd. Mr. Bowers has 25 years of domestic oil and gas exploration and production experience. Prior to his current position at Capitol Energy, Mr. Bowers served in several capacities of increasing responsibility including Vice President, Exploration at Petromet Resources Ltd. (1999 - 2001) and Remington Energy Ltd. (1994 - 1999) and Manager, Peace River Arch Team at Amerada Hess Canada Ltd. (1984 - 1994). Mr. Bowers holds a Bachelor of Science in Geological Engineering from the University of Saskatchewan and is both a Professional Engineer and Professional Geologist with the Association of Professional Engineers, Geologists and Geophysicists of Alberta.

GRANT D. BILLING
Director
Mr. Billing joined the Board of Capitol Energy in late 2003. He is the Executive Chairman of the Board of Superior Plus Inc. (since 1998), an income trust in the propane, pulp chemicals, drywall and ceilings and natural gas retailing business. He was previously President and CEO of Norcen Energy Resources Limited (1994 - 1998), an oil and gas exploration and production company. Mr. Billing also serves on the Board of Provident Energy Trust.

JOHN A. BRUSSA
Director
Mr. Brussa is a senior partner in the Calgary-based energy law firm of Burnet, Duckworth & Palmer LLP (since 1982), and his current practice includes structured finance, taxation of international energy operations, corporate and income trust restructuring and reorganization, dispute resolution and acquisitions and divestitures. He is also a director of a number of energy and energy related trusts including Penn West Petroleum Ltd., Baytex Energy Trust, Energy Savings Income Fund, Progress Energy Trust, Focus Energy Trust and Harvest Energy Trust, as well as oil and gas growth companies such as Rider Resources Ltd., Crew Energy Inc., Galleon Energy Inc. and Highpine Oil and Gas Ltd.

JAMES S.A. MACDONALD
Director
Mr. MacDonald is Chairman and a Managing Partner (and a founding partner) of Enterprise Capital Management Inc., an investment management company. Previously, Mr. MacDonald was Deputy Chairman of ScotiaMcLeod Inc., a major Canadian investment dealer. He had a 27 year career with ScotiaMcLeod, which included experience in investment research, corporate finance and mergers and acquisitions with management responsibilities in Calgary, Toronto and London, England. Mr. MacDonald is also Chairman of VFC Inc., and a director of MDS Inc., Rogers Sugar Inc. (and a trustee of the Rogers Sugar Income Fund), and Superior Plus Inc.

MURRAY R. NUNNS
Director
Mr. Nunns is an independent businessman with over 25 years of experience in domestic and international oil and gas exploration and production. He was previously President, CEO and Director of Crispin Energy Inc. (2003 - 2005) until it was acquired by Pengrowth Energy Trust. Mr. Nunns held a variety of management positions at Rio Alto Exploration Ltd. (1993 - 2002), including Executive Vice President of Exploration and Development as well as COO. Prior to that, Mr. Nunns worked in several capacities with Unocal Exploration Ltd. (1986 - 1993) including Chief Geologist for Unocal Canada and in portfolio management of the international exploration program. He serves on the Board of PennWest Energy Trust and three private junior companies.

SHELDON REID
Director
Mr. Reid is President and CEO and a Director of Cell-Loc Location Technologies Inc. He has 20 years of business experience, having held several senior management positions with executive responsibilities primarily in the resource sector. In these roles, he focused on marketing and corporate development for commercial products and was responsible for negotiating complex transactions, often in an international environment. Most recently he was Vice President of Marketing for Norcen Energy Resources.

OFFICERS

R. L. (MONTY) BOWERS
President & CEO, Director
Mr. Bowers is President, CEO and a Director of Capitol Energy Resources Ltd. Mr. Bowers has 25 years of domestic oil and gas exploration and production experience. Prior to his current position at Capitol Energy, Mr. Bowers served in several capacities of increasing responsibility including Vice President, Exploration at Petromet Resources Ltd. (1999–2001) and Remington Energy Ltd. (1994–1999) and Manager, Peace River Arch Team at Amerada Hess Canada Ltd. (1984–1994). Mr. Bowers holds a Bachelor of Science in Geological Engineering from the University of Saskatchewan and is both a Professional Engineer and Professional Geologist with the Association of Professional Engineers, Geologists and Geophysicists of Alberta.

DOUG DEARING
Vice President Finance & Chief Financial Officer
Mr. Dearing is Vice President, Finance and CFO of Capitol Energy Resources Ltd. He has 25 years of experience in Finance and Accounting within the domestic oil and gas industry. Previously, Mr. Dearing has served the exploration sector in several capacities of increasing responsibility including Director, Manager of Finance, CFO and Controller. In 1983, Mr. Dearing obtained his Chartered Accountants designation (1983) while articling at Price Waterhouse and holds a Bachelor of Commerce from the University of Calgary.

D.C. (DON) STACHIW
Vice President Exploration & Chief Operating Officer
Mr. Stachiw is Vice President of Exploration and COO of Capitol Energy Resources Ltd. Mr. Stachiw has 21 years of domestic and international oil and gas exploration and production experience. Prior to his current position at Capitol Energy, Mr. Stachiw served in several capacities of increasing responsibility including senior technical geological, managerial and Vice President positions at a series of major and junior exploration and production companies. Mr. Stachiw holds an Honors Bachelor of Science in Geology from the University of Toronto and is a professional Geologist with the Association of Professional Engineers, Geologists and Geophysicists of Alberta.

JOHN LAMACCHIA
Vice President Engineering & Operations
Mr. Lamacchia is Vice President, Engineering and Operations of Capitol Energy Resources Ltd. Mr. Lamacchia has 25 years of diversified office and field experience in the areas of reservoir, exploitation, petrophysics, production, and operations engineering. Prior to his current position at Capitol Energy, Mr. Lamacchia served in several capacities of increasing responsibility including President of KTS Energy Inc. (2003-2004) and Manager of Operations at Nycan Energy Corp. (1999–2003). Mr. Lamacchia is a member of the Association of Professional Engineers, Geologists and Geophysicists of Alberta.

JOHN NESBITT
Vice President Land
Mr. Nesbitt brings 25 years of supervisory, surface and negotiating experience to Capitol, working extensively in the Western Canadian Sedimentary Basin utilizing an innovative, proactive and highly successful approach to partnerships with industry players. His diverse skill sets compliment the management team and helps the company with its business plan execution.

CORPORATE INFORMATION

BOARD OF DIRECTORS

JIM NIEUWENBURG [2]
Chairman
Capitol Energy Resources Ltd.

R.L. (MONTY) BOWERS
President & CEO
Capitol Energy Resources Ltd.

GRANT BILLING [1,3]
Executive Chairman
Superior Plus Inc.

JOHN A. BRUSSA [2,3]
Partner
Burnet, Duckworth & Palmer LLP

JIM MACDONALD [1,3]
Managing Director
Enterprise Capital Management Inc.

MURRAY NUNNS [2]
Independent Businessman

SHELDON REID [1]
President & CEO
Cell-Loc Location Technologies Inc.

[1] *Audit Committee Member*
[2] *Reserves Committee Member*
[3] *Corporate Governance & Human Resources Committee Member*

OFFICERS

R.L. (MONTY) BOWERS
President & Chief Executive Officer

DOUG DEARING
Vice President, Finance & Chief Financial Officer

D.C. (DON) STACHIW
Vice President, Exploration & Chief Operating Officer

JOHN LAMACCHIA
Vice President, Engineering & Operations

JOHN NESBITT
Vice President, Land

BANKERS
National Bank of Canada

AUDITORS
KPMG, LLP

SOLICITORS
Burnet, Duckworth & Palmer LLP

INDEPENDENT QUALIFIED RESERVES EVALUATOR
McDaniel & Associates Consultants Ltd.

REGISTRAR AND TRANSFER AGENT
Computershare Trust Company of Canada

STOCK LISTING
TSX Venture Exchange
Symbol: CPX

CORPORATE HEAD OFFICE
Capitol Energy Resources Ltd.
Suite 700, 407 2nd Street SW
Calgary, AB T2P 2Y3
T: 403.508.6310
F: 403.508.6309

WEBSITE
www.capitolenergy.ca

GENERAL INQUIRIES
cpxinfo@capitolenergy.ca

INVESTOR RELATIONS
montyb@capitolenergy.ca
or dougd@capitolenergy.ca

ANNUAL GENERAL MEETING
May 11, 2006 at 3:00 PM (MDT)
Metropolitan Centre
Grand Lecture Theatre
333 Fourth Avenue South West
Calgary, AB T2P 0H9

ABBREVIATIONS

OIL AND GAS LIQUIDS

bbls	barrels of oil or natural gas liquids
bbls/d	barrels of oil or natural gas liquids per day
mbbls	thousands of barrels
mmbbls	millions of barrels of oil
NGLs	natural gas liquids

NATURAL GAS

bcf	billions of cubic feet
mcf	thousands of cubic feet
mmcf	millions of cubic feet
mmcf/d	millions of cubic feet per day
GJ	Gigajoule

OIL EQUIVALENT

boe	barrels of oil equivalent (6,000 cubic feet of natural gas being equivalent to one barrel of oil)
boe/d	barrels of oil equivalent per day
mboe	thousands of barrels of oil equivalent
mmboe	millions of barrels of oil equivalent

OTHER

/d	per day
$000	thousands of dollars
$/	dollars per
$C	Canadian dollars
$US	United States dollars
2D	two dimensional seismic
3D	three dimensional seismic
API	American Petroleum Institute density units
APO	After Payout
ARTC	Alberta Royalty Tax Credit
BA	Banker's Acceptance
BPO	Before Payout
D&A	Dry and Abandoned
FD&A	Finding, Development and Acquisition costs
G&A	General and Administrative
sq. km	square kilometer
MD&A	Management Discussion & Analysis
MRL	Maximum Rate Limitation
OOIP	Original Oil In Place
WTI	West Texas Intermediate

concept, writing and design: Sasges Inc and National PR
photography: Victor John Penner
production: DaSilva Graphics
printed in Canada by Blanchette Press


Capitol Energy
Resources Ltd.